CREDITS AND COLLECTIONS IN THEORY AND PRACTICE

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DISSERTATION

PRESENTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF DOCTOR OF PHILOSOPHY IN THE GRADUATE SCHOOL OF THE OHIO STATE UNIVERSITY

BY

THEODORE N. BECKMAN, B.Sc. in Bus. Adm., M.A.

The Ohio State University

1924

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AUTOBIOGRAPHY

I, Theodore N. Beckman, was born in Russia September 3, 1894. I received practically all of my secondary school education in the public schools and Gymnasiums of Bessarabia, Russia. Both my undergraduate and graduate education I received at the Ohio State University from which I obtained the Degree of Bachelor of Science in Business Administration in 1920, the degree of Master of Arts in 1922, and the degree of Doctor of Philosophy in 1924. While in residence at the Ohio State University from 1920 to 1924 I occupied the positions of Assistant Instructor in Economics and Sociology, Instructor in Economics and Sociology, Instructor in Business Organization, and Assistant Professor of Business Organization.

To My Wife

PREFACE

In the past, men have come into the credit field without previous preparation. Their entrance into this line was frequently not a matter of deliberate choice and planning and they have had to acquire the special knowledge of the problems that presented themselves for solution largely through experience. However, the attendant waste of time and money, together with the increasing complexity of the credit system and its operation, has instilled in the modern and progressive credit manager a desire to proceed scientifically. He has discovered that although some of the special knowledge required of him can be learned only from experience, much can also be acquired through diligent study. Accordingly, many of the colleges and universities are at present offering courses in Credits and Collections, and successful attempts have been made on the part of the Institute of Credit of the National Association of Credit Men, through the classes which are conducted under its direction, to introduce those entering the profession to this tremendously important subject and to aid those already in the field in the acquisition of supplementary knowledge and a broader perspective.

To accelerate the movement in this direction, the author has long felt that there was a need for a book covering the general field of credits and collections which would serve both the college student and the man in business; a book that would not only give the reader exact, definite, and practical information, but one which would also obviate the necessity of resorting to several books dealing with the various phases of the subject.

This book attempts to cover the entire field of credits and collections, both foreign and domestic. Although special attention is given to mercantile credit, attempts have nevertheless been made throughout to maintain a proper balance between the various classes of credit and to set forth in as logical and concise a manner as possible the best theory underlying credit work and the lessons learned as a result of the experiences of men actually practicing the extension of credit and the collection of accounts.

The author is greatly indebted to many recent discussions in books and in trade magazines for which acknowledgment is made

in the appropriate places in the text. The names of the business men and of others who have furnished the author with information and other material not in published form, are too numerous to give. There are, however, a few to whom he is particularly indebted: J. E. Fagan, manager of the Central Ohio Credit Interchange and Adjustment Bureau; Raymond Link, credit manager of the Ohio National Bank; A. G. Sharkey and J. E. Ryder, manager and assistant manager, respectively, of the Columbus Branch of R. G. Dun & Co.; and W. Vorhees, of the Bradstreet Company. The author wishes, also, to acknowledge the invaluable assistance rendered by Dean J. E. Hagerty and Professor W. C. Weidler, of Ohio State University, who have offered many valuable suggestions and have read portions of the manuscript.

THEODORE N. BECKMAN.

COLUMBUS, OHIO,
May, 1924.

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PART I

FUNDAMENTAL PRINCIPLES OF CREDITS AND COLLECTIONS

CREDITS AND COLLECTIONS IN THEORY AND PRACTICE

CHAPTER I

NATURE AND FUNCTIONS OF CREDIT

Credit Defined.—Notwithstanding slight differences in the wording, practically all definitions of credit include directly or by implication the two most important characteristics of confidence and of futurity. With very few exceptions, these definitions may be divided into two classes, depending upon whether credit is viewed as an executed act resulting in a right to receive and demand payment, or as a power, both realized and potential. The former is a legalistic conception, according to which credit is conceived of as the other side of debt—it is a right to receive and demand payment—while a debt constitutes an obligation to make payment. Thus, credit is a relation involving both a creditor and a debtor, and this identical relation is at the same time a credit or a debt, depending upon the way in which it is viewed. It is this conception that is responsible for the numerous attempts at defining the term as a "right to demand money."

Although correct when viewed from the standpoint of the creditor, the legalistic conception reveals the truth but partially, for, according to the above definition, credit does not exist until goods have been transferred or services rendered and the debt created. It follows, therefore, that the credit of an individual or firm would always equal the amount of indebtedness actually incurred and that it would be improper to use expressions similar to the following, namely, "a person's credit is good," or "a person has unlimited credit," when, as a matter of fact, no or very little credit has been utilized as yet. Such restriction in usage of the term would thus run against the current of simple business parlance.

Obviously, it appears more reasonable to think of credit as a *power,* at least from the standpoint of borrowers, to obtain goods

or services on the basis of the seller's belief that payment will be made as agreed. Thus, in its commonly understood business use, credit may be defined as the power to secure economic goods or services in return for a promised equivalent payable at a future time. The equivalent may consist of commodities or services. Usually, however, credit obligations are discharged by money payments or credits of more or less general acceptability, which ordinarily pass as money, as will be shown in the following pages. Thus, credit may be something potential or realized, that part which has been used becoming a debt, while the unutilized portion constitutes the residue of power up to the limit which is placed upon it by creditors.

From the foregoing it would appear incorrect for a seller of goods to state "we do not give credit." Instead, he should have said "we do not accept credit," for it is the prospective buyer who gives or offers his credit in exchange for the merchandise purchased or services obtained. The seller may accept or reject this intangible commodity, depending upon whether or not, in his opinion, the buyer possesses the willingness and ability to redeem his promise at maturity. It is said that, in practice, credit is stood on its head and sellers on time are referred to as credit grantors; but since it is difficult to inaugurate changes of this nature successfully, the practical application of the term is generally adopted. It seems, however, that it is possible to reconcile the practical usage with the definition laid down, by thinking of the seller as granting the buyer permission to use his purchasing power as represented by his ability and willingness to pay at a future time. It is probably because of this conception that John Stuart Mill defined credit as "the permission to use another's capital."

Various Conceptions of Credit.—In addition to the conceptions mentioned in preceding paragraphs, the term has many different shades of meaning. Few of the attempts at defining it otherwise than the manner in which it is employed in the previous paragraphs are at once clear and comprehensive. Prendergast, for example, states that "credit is the confidence that is reposed in the ability and purpose of men to meet their obligations,"[1] while Laughlin defines credit as "the machinery invented to accomplish the purposes of capital."[2] Although the

[1] PRENDERGAST, W. A., "Credit and Its Uses," p. 8.
[2] *Ibid.*, p. 10.

word "credit" is derived from the Latin *credo,* "I believe," it is by no means synonymous with confidence, but simply indicates that confidence is essential as a basis for a credit system or credit transaction. In the second case, "credit" is apparently confused with "credit system," the latter consisting of the mechanical aids by means of which credit transactions are conducted.

Credit is also frequently confused with a "credit transaction," which involves the actual transfer of goods or services for a future equivalent. Then, too, a person is "given credit" upon the completion or performance of a heroic deed, or something which is looked upon with favor. Finally, from the bookkeeper's point of view, credit is something owed on an account; it is the converse of debit.

Relation Between Credit and Wealth.—The layman ordinarily confuses credit with wealth. Such conception must be emphatically denied. Credit is not wealth, although frequently employed as such. Wealth is any material or physical thing that satisfies a human want, provided that thing is limited in amount. From the viewpoint of the seller, credit is, technically speaking, a right to the future use of wealth. The distinction between the two economic terms may be easily demonstrated by an illustration as follows:

	X		Y		Z		Total Wealth
Case I			Bldg. valued.	$10,000	Cash	$10,000	$20,000
Case II	Bldg. valued.	$10,000	Cash	10,000	Mortgage	10,000	20,000

In the foregoing illustration it is assumed that in Case I, X possesses no property or money with which to purchase the building from its present proprietor Y, and that Z, a building and loan association, has the money available for loans on property. The total wealth in possession of the three parties as given amounts to $20,000. Case II shows that X has borrowed on a mortgage from Z the sum of $10,000 with which to make payment for the building to its present owner. In this transaction, credit is extended by the third party to the first. The total amount of wealth is not changed, however. The physical property still consists of the two items: the building, and cash. The mortgage is but a piece of paper granting the mortgagee the right to the use of the building in case of default

in payment of the debt incurred, in accordance with the terms of the agreement, by the mortgagor.

Although credit is not wealth, nevertheless a very close and intimate relationship exists between the two. Credit is indirectly an aid in production. It leads to an enhancement in wealth through the transfers of title which it involves, as will be shown in another connection. "Credit makes possible an increase in the production of wealth and facilitates the utilization of capital. However, it is neither wealth nor capital."[3]

It should be noted at this point that the foregoing discussion involving a definition of the exact relationship between credit and wealth, is viewed entirely from the standpoint of society at large. Society may thus be likened to a parent corporation, the balance sheets of whose subsidiaries are combined into one consolidated statement. In this process, numerous items on the assets side of some of the subsidiary balance sheets are automatically eliminated and canceled by corresponding items on the liabilities side of the statements of other subsidiaries, and only the net results are recorded on the final report of the parent organization. A similar procedure would be followed were the total wealth of society compiled in one statement. Many items listed among the assets of some individuals or businesses would be canceled by similar amounts listed among the liabilities of others.

From the standpoint of individuals or business firms, credit does constitute wealth and should be reckoned as such. Thus, we find that the largest portion of the wealth of most of our millionaires consists in a great measure in securities of different types, which constitute but instruments of credit.

The Importance of Credit in Modern Business.—Unfortunately, there are no exact data available indicating the extent to which credit is utilized in the conduct of modern business. An approximate idea of the situation, however, may be gathered from an analysis of the figures compiled by Dr. David Kinley in a comprehensive investigation conducted by him for the National Monetary Commission. According to this authority, the average retail and wholesale business done with various credit instruments, including checks, approximated 86 per cent of the total.

In view of the fact that this investigation extends back to

[3] HAGERTY, J. E., "Mercantile Credit," p. 17.

1910, the data presented cannot be taken as a final barometer of the present-day uses of credit. The changing character of the retail business has brought about numerous important changes in the volume of credit since that date. With the growth and development of the chain-store type of retail organization and its attendant "cash-and-carry" system, there has come about a diminution in the use of open book accounts. On the other hand, purely credit stores have increased in size and number. In addition, sales on the instalment plan have increased in amount, particularly in the marketing of products such as pianos, washing machines, automobiles, and the like. Again, the use of checks in payment of accounts has been on the up grade since 1910. Then, too, the enormous amount of commercial paper, including trade acceptances and Federal Reserve notes brought into existence by virtue of the favorable rediscounting provisions of the Federal Reserve System established since the date in question, must be given adequate consideration in determining the extent to which credit is used in present-day business. It is, therefore, the belief that, were an investigation conducted with a view of determining the importance of credit in modern business, a large net change in its favor as compared with its status of 1910 would be disclosed, for the reasons aforementioned.[4]

Functions of Credit.—One of the essential services rendered by credit to society at large consists in substituting the regular media of exchange. Its use in that capacity is highly essential, and at the same time most convenient. Without it, the volume of business transactions would be entirely contingent upon the supply of the precious metals making up our media of exchange. The amount of "hard" money is far from adequate in caring for our normal business needs. Besides, the delay incident to the transfer of either gold or silver in payment for individual purchases would make such a process both clumsy and inconvenient. Furthermore, the expense involved in physically transporting the precious metals and insuring them while

[4] In this discussion, the enormous amounts of irredeemable paper or fiat currency issued through the medium of central banks controlled by the various governments of the continental countries of Europe are entirely disregarded because such development in the practical exclusion of gold or its equivalent is obviously abnormal and constitutes but an aftermath of the Great War.

in transit would be considerable, thereby adding to the already high cost of doing business.

Were credit arrangements to cease entirely, the loss due to depreciation incident to the considerable handling of "hard" money will have to be taken into account. The existing scarcity of these metals would thus be further accentuated. Indirectly, the effect of the total cessation of credit machinery would be to lower the culture of the people through the removal of gold and silver from the arts, for business purposes.

Credit makes available for business purposes capital that would otherwise lie idle. Its use causes the thrifty individual to entrust his savings to a banking institution, which, in turn, loans it out to enterprising individuals for productive employment, in exchange for a promise to repay the amount at a future date. As a result, capital is employed more productively, and the benefits derived therefrom inure to all parties concerned. The individual who, through the medium of the bank, finds a profitable place for the employment of his funds is benefiting from the transaction by the interest compensation advanced to him by the banker. The ultimate borrower, assuming competency on his part, gains from the process through his ability to earn, by use of borrowings, an amount in excess of what he must pay the banker for the privilege of using funds belonging to others. The middleman—the banker—naturally absorbs the difference between what he receives from the borrower and what he pays to the lender.

Another common form in which capital is made more productive is through investments in bonds and stocks. In purchasing a security, the investor virtually lends his capital to the issuing corporation in exchange for its written promise to pay at a future time a proportional equity in accordance with the specific agreement under consideration. This makes possible the growth of large-scale enterprises, which is, in turn, responsible for the specialized industrial society of the present age. Through the proper employment of capital by borrrowers, more commodities of a larger variety and superior quality are produced, resulting in a direct benefit to borrower and lender, and indirectly serving society through keener competition, better products, and lower prices.

A fourth important advantage derived from the use of credit is that it enables an entrepreneur to adjust the volume of capital

to the varying needs of his business. He may, by this means, enlarge the volume of production by borrowing additional capital during periods of extraordinary business activity and reduce the amount of capital with the approach of dull periods.

Chief among the minor functions of credit are the following:

1. Credit makes for independence of thought and action. It causes people to save. Capital would be useless and profitless to those who possess no means of employing it themselves. The use of credit offers many opportunities for its employment, thereby making possible a return on the savings, which, in turn, serves as an inducement and encouragement to develop habits of thrift still further.

2. Credit prevents hoarding on the part of those who desire to save and provide for emergencies. The use of credit not only places the principal in a more secure position in relation to theft and other hazards to which hoardings are subjected, but also secures an income on the investments, frequently sufficient for running expenses and further accumulations.

3. Credit bridges the gap between capital and labor, by enabling the latter to secure its assistance in an attempt at independent enterprises.

4. Credit enables individuals to acquire an education on borrowed funds, and it also permits the purchase of all sorts of consumption goods, including homes, pending the receipt of income and before the entire purchase price is available.

Weaknesses of Credit.—The principal weaknesses of credit economy lie in the abuses of the system. Due to extreme laxity on the part of banks and sellers of goods in the extension of credit, much speculation and overtrading is caused. These often lead to fraud and embezzlement. It also aids individuals to live beyond their means and increases extravagance. The results are frequently disastrous. The fault, however, lies not so much with the system *per se* as with the use made of it and the efficiency with which it is operated and maintained. The more efficient credit dispensation and management become, the less likely are the abuses hereinbefore mentioned to be repeated and the greater the benefits that will result from our credit system.

Credit and the Business Cycle.—The oscillating movement of business commonly known as the business cycle, which has attracted so much attention during the immediate post-war reconstruction period, has been variously pictured and charted,

depending upon the number of stages or periods into which it has been divided. Not infrequently is the business cycle likened to a clock with 12 periods or divisions. According to this conception, the first period begins with the peak of prosperity and is conspicuous for the large profits attending it. In the second period, inefficiency prevails; the symptom of this period consists in a general decline in bond prices. Dishonesty coupled with a general decline in stock prices marks the third period; and a crime wave, accompanied by a general decline in commodity prices, sweeps the country during the following stage. The fifth and sixth periods are marked by lack of confidence and consolidation of homes, respectively. The external sign of the former is a general condition of unemployment, and that of the latter a decline in real estate values.

With the seventh period the wheel begins to turn upward once again, due primarily to increased thrift and correspondingly lower interest rates. Efficiency is on the increase during the eighth stage and, as a result, bond prices recover. During the subsequent stage, prices of stocks generally rise and, due to the revival of religious interest normally caused by bad times, a more universal confidence is inspired. Buying, which has long been at a standstill, is finally resumed during the tenth period of the business cycle, thereby increasing commodity prices. The constantly rising market leads into the next period, the stage of activity and general employment. Finally, the summit is reached. The external sign of the twelfth and last period consists in a marked increase in interest rates, and general prosperity prevails throughout the land.

It should be observed that the lines of demarcation between the various periods, as outlined above, are at best shadowy and indistinct and in many instances overlapping. Accordingly, the business cycle has been divided by most authorities into four principal stages, following the shape of a wave and characterized by a crisis, depression, revival, and prosperity, the first of which is usually very brief and dramatic. In still other instances, the business cycle is conceived of as consisting of two alternate periods of dullness and prosperity, the former characterized by an abnormally large number of failures and liquidations and the latter by general buying movements.

All of the theories thus far advanced in an attempt to explain the causes for the recurrence of the successive phases of business

cycles are divided into cosmic or physical and economic causes. Jevons' "Sun Spot Theory" and Moore's "Rainfall Theory" characterize the first class of explanations. Among those theories which attempt to explain the economic causes of business cycles may be mentioned Beveridge's "Competition Theory," May's theory of the "Discrepancy Between Wages and Production," Hobson's theory of "Oversaving," Aftalion's theory of "Diminishing Utility," Veblen's theory of the "Discrepancy Between Profits and Current Capitalization," Fisher's theory of the "Lagging Adjustment of Interest Rates," and Carver's theory of the "Dissimilar Price Fluctuations of Producers' and Consumers' Goods."[5]

At least two of the theories enumerated attribute the business cycle phenomenon to undue expansions of credit. According to Professor Thorstein Veblen, a rise in prices (which may be caused by an increase in demand for supplies on the part of heavy purchasers or by a sudden discovery of gold) brings about increased activity. On a rising market everybody feels confident, optimism is the prevailing keynote, large profits are earned by all, still larger profits are anticipated, and investments in plant and machinery are increased correspondingly. Values of properties rise, and this fact makes them more readily acceptable as collateral behind loans, hence expansion of credit. As long as the confidence in anticipated higher earnings lasts, so long will the upward movement of the process continue. Finally, the bottom drops out and the process undermines itself. As anticipated margins of profit are not realized, prices begin to tumble. Pessimism replaces optimism, credit for the most commendable enterprises is refused, collateral shrinks in value, loans are called in, and collections are made closer. Deflated prices enhance the difficulty in meeting obligations, and liquidations follow.

Professor Irving Fisher asserts that the upward movement of the business cycle is greatly accelerated by the lagging adjustment of interest rates to prices on a rising market. As prices advance, interest rates rise, but not so rapidly. Borrowers take advantage of this opportunity and increase their borrrowings. Since such loans are made through banks, an enhancement in deposit currency is effected, which, when coupled with a more rapid circulation of money and credit instruments, causes prices to climb still higher. The process continues until interest rates are

[5] Mitchell, W. C., "Business Cycles," pp. 6–18.

effectively adjusted, when the reverse process begins and the downward movement of the business cycle commences.

To remedy the situation, several suggestions have been made. And the important thing to bear in mind is that none of these proposals make any attempt to remove the various stages of the business cycle completely, for it has been justly concluded that crises, for instance, are not "sudden catastrophes interrupting the normal course of business," but are treated as normal occurrences inherent in our present-day money economy system. No less than 15 crises have occurred in the United States alone within the past 110 years, and all of them with remarkable regularity, each cycle culminating every 7 or 10 years in a crisis followed by a state of dullness and inactivity of varying length. What these plans aim to do is to *control* the business cycle properly, so that peaks of prosperity may be lowered and valleys of depression raised, with a view to equalizing or stabilizing business conditions and buying movements.

To eliminate the deep fluctuations and iron out the enormous folds, it has been suggested that, just prior to the big business boom preceding the peak of prosperity, interest rates be raised with a view to preventing undue expansion.[6] Another plan consists in the use of governmental and railway purchases as a balance wheel.[7] It is based on the belief that public works should be contracted for during depressions and that long-range planning could and should be applied to railroads, public utilities, and even large private industries. Unemployment insurance paid by the employer and based upon the number of unemployed is still another remedy. The purpose of basing the premium on the number of unemployed is to induce the employer to do long-range planning and to cause him to be more cautious in the expansion of his plant and equipment during a period of rising prices and general buying movements. Finally, it is believed that greater knowledge of current business conditions coupled with better business forecasting are likely to reduce considerably the expansion peak and correspondingly raise the valley of depression.

From the foregoing it is obvious that credit is dangerous when out of proportion to available capital. Business is sound only

[6] Mitchell, W. C., "The Crisis of 1920 in the United States," paper read before the American Economic Association on Dec. 27, 1921.

[7] *Ibid.*

to the extent to which credit is sound, and *vice versa*. Credit apparently is one of the principal controlling factors in business. Credit men can contribute a sizable share toward the alleviation of the sufferings incident to the violent fluctuations referred to in previous paragraphs, by scrutinizing credit risks more carefully during and at the beginning of a business boom. This practice would obviate the necessity of adopting an extremely rigid policy when the depression is finally reached. They should always bear in mind that good times do not last forever and that inferior business conditions are likely to coincide with the periods in which payment is expected from debtors.

Through a continual improvement in credit methods and a keener appreciation on part of credit grantors of the essential causes of crises and depressions, it should be possible to eliminate excessive peaks and depressions and to minimize the disastrous effects of crises. Credit men should ever remember that abuse of the credit system and an unsound credit policy make speculation possible, maintain unprofitable enterprises, cause waste and extravagance, and generally pave the way to failure and ruin.

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CHAPTER II

FORMS OF CREDIT INSTRUMENTS

To comprehend properly and fully the principles underlying credit work, a person must first familiarize himself with the meaning and uses of the different types or forms of credit instruments. Credit instruments may be defined as evidences of obligations to pay in money or goods at a future time. These constitute the tools of credit work and may be divided into two classes: credit of general and unlimited acceptability, and credit of limited acceptability.[1] Instruments of the former class are passed freely from hand to hand, and are universally acceptable because of their virtual guarantee by the National Government, whereas credit instruments of the latter class are usually accepted only after adequate consideration of the character and financial responsibility of the credit risk. The former includes greenbacks, national bank notes, Federal Reserve Bank notes, and Federal Reserve notes. The second class comprises all other forms of credit instruments. It is not intended to treat here of the first major division exhaustively, since a great deal has already been written on the subject. A brief discussion, nevertheless, may prove useful and profitable to the credit manager.

CREDIT FORMS OF UNLIMITED ACCEPTABILITY

United States Notes.—United States notes, commonly known as "greenbacks," came into existence during the Civil War period. A total of $450,000,000 was issued originally, of which all but approximately $100,000,000 are outstanding at present. They were issued as a forced loan and the security behind them consisted merely of the general credit of the Federal Government. They have been redeemable in gold since 1879 and are now legal tender for payment of all debts, public and private, except customs duties and interest on public debt.

National Bank Notes.—These are issued by national banks against Government bonds deposited in the United States

[1] Ettinger and Golieb, "Credits and Collections," p. 12.

Treasury. They are not legal tender, and may be retired under the provisions of the Federal Reserve Act at the discretion of the issuing bank.

Federal Reserve Bank Notes.—These instruments are designed to substitute for national bank notes when the latter are retired under the provisions referred to in the previous paragraph. The same conditions apply to these as to national bank notes. Both are secured by 1 and 2 per cent Government bonds deposited in the United States Treasury.

Federal Reserve Notes.—Federal Reserve notes are obligations of the Federal Government and authorized by the Federal Reserve Act of 1913. Under the provisions of the act, the Federal Reserve Board may, at its discretion, issue these instruments to any reserve bank upon deposit of 100 per cent in commercial paper and bills discounted by it for member banks. In addition, these notes are protected by a gold reserve of at least 40 per cent of the quantity of notes in circulation. Federal Reserve notes are acceptable by all reserve banks and member banks and for all taxes, customs, and other public dues, but for no other purposes are they to be considered legal tender.

It is frequently argued that bank notes are not credit instruments, because they are used as money or currency. Nevertheless, it seems that, although they are universally as acceptable as gold itself would be, they are no more synonymous with gold than are bonds of corporations or promissory notes of individuals whose reputation for paying promptly is established beyond the shadow of a doubt. To prove this contention it is but necessary to look into the early history of our nation, when wildcat banks were plentiful and bank notes were carefully scrutinized and valued in direct proportion to the reputation of the bank whose name they were bearing. The only reason why bank notes constitute at the present time an accepted part of our monetary supply is because of the virtual guarantee of these notes by the National Government, and the sound banking structure of today, particularly since the establishment of the Federal Reserve System.

CREDIT FORMS OF LIMITED ACCEPTABILITY

The remaining credit instruments may be properly subdivided into promises to pay and orders to pay. The former includes book accounts, promissory notes, and bonds. The latter com-

prises checks and drafts of all kinds, including acceptances and letters of credit.

Promises to Pay

Book Accounts.—The book account is probably the oldest form of credit. Even in primitive times, records were kept of commodities loaned. Upon deposit of funds with a bank all the depositor receives as acknowledgment of the obligation on the part of the bank is a duplicate record of the account in the bank's books. Thus the depositor exchanges his funds for the bank's promise to pay at a future time, and the credit transaction takes the form of a book account. Similarly, when a consumer purchases goods from a retail dealer and has them "charged," the only evidence of the transaction is an entry on the retailer's books debiting the customer with the amount involved. Again, purchases nowadays by retailers from manufacturers, jobbers, or functional middlemen, such as commission houses and selling agents, are, in numerous instances, evidenced merely by entries of the charge in the ledgers of the respective sellers and by the invoices of the amount forwarded to the buyer, which, when paid, closes the transaction.

Although the record of the debt on the books of the creditor gives the latter a right of action against the customer for the value of the goods, the book entry is rarely as satisfactory as a written acknowledgment of the debt on part of the debtor. More disputes as to the amount of indebtedness are likely to arise than when a promissory note or other written evidence is given for the amount. Furthermore, while the book account may be sold or assigned and the buyer or the assignee thereof has the same right of action against the debtor that the original creditor had, nevertheless creditors of sellers or assignors of book accounts regard such action with suspicion, for it frequently denotes financial weakness on the part of the seller or assignor of such accounts. It is also at the same time difficult and inconvenient to discount accounts receivable and borrow money on them, whereas other forms of credit instruments are normally discounted at the banks.

Open book accounts are the simplest form of credit, however, and the effect of their use is to stimulate sales, minimize the time required in making settlement for small purchases in retail

stores, and to do away with the necessity of carrying large sums of money for cash payments.

Promissory Notes.—"A negotiable promissory note is an unconditional promise in writing made by one person to another, signed by the maker, promising to pay on demand or at a certain or determinable future time a definite sum of money to order or to bearer" (see Fig. 1). Promissory notes are given by purchasers in payment of goods, or by borrowers in exchange for funds or credit extended to them by lenders. They are among the most popular credit instruments and may be either negotiable or non-negotiable. If all the requirements outlined in the definition are fulfilled, the instrument is negotiable. The promise must be in writing and signed by the maker; it must be an unconditional promise to pay a definite amount of money;

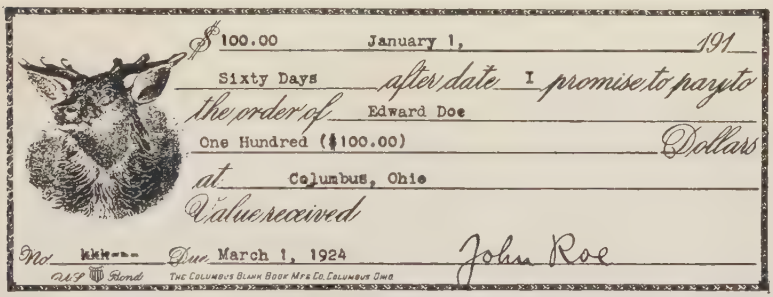

$100.00 January 1, 191
Sixty Days after date I promise to pay to
the order of Edward Doe
One Hundred ($100.00) Dollars
at Columbus, Ohio
Value received
No Due March 1, 1924 John Roe
The Columbus Blank Book Mfg. Co. Columbus Ohio

FIG. 1.—Promissory note.

the maturity date must be either fixed or determinable; it must be payable to order or to bearer, and not to a particular person or firm; and, finally, the instrument must be delivered. Not until a promissory note is delivered does it create an obligation or right of action, except in case of a holder in due course.

The promissory note is an excellent evidence of debt. It practically eliminates all disputes regarding the amount owed by the debtor, the date when payment must be made, the amount of discount allowed, etc. It is an effective means of enforcing prompt payment of bills. Notes are usually paid at maturity, whereas book accounts are often neglected and the due date thereby extended. Furthermore, most promissory notes are negotiable and, therefore, more readily transferable by indorsement and delivery. The fact that promissory notes may be transferred a great many times causes them to perform the

functions of a medium of exchange. Such function is greatly facilitated by the indorsement of the payee, which makes it a double-name paper, and by the fact that a third innocent party, namely, a *bona fide* purchaser, is ordinarily free from all the defenses which may be advanced against the original payee. Lastly, promissory notes can be used as collateral for loans obtained from banks more readily than can book accounts.

Notwithstanding the advantages of promissory notes over book accounts as a form of credit from the standpoint of the creditor, the latter are more extensively employed. Consumers seldom give promissory notes in exchange for goods purchased from retailers, unless an instalment transaction is involved. The same observation, though to a lesser degree, applies to dealings between retailers and wholesalers or between wholesalers and manufacturers. It is still uncommon for a merchant to give a promissory note to the seller in the ordinary course of business, save when the account is past due and an extension is granted on that basis, or when the customer is regarded an inferior credit risk.

The limited use of promissory notes in settling accounts between merchants is due primarily to the use of "cash discounts." Many merchants are anxious to pay cash within a specified period of time and receive cash discounts. If a note is to be given, it is difficult to determine the exact amount when it is not known definitely whether the option of paying the bill before due and receiving a cash discount will be exercised.

Another explanation of the limited use of promissory notes lies in the ever-growing tendency on the part of merchants to buy in small quantities and frequently, and thereby increase stock turns. It is obviously inconvenient to settle by note frequently for small amounts. Lastly, it is to the advantage of buyers to use open book accounts instead. Adjustments are more easily secured before the bill is paid when no written evidence of the debt is given.

Nevertheless, the volume of promissory notes given to banking institutions in exchange for bank loans is constantly and steadily growing. A similar condition obtains in case of commercial paper sold in the open market through note brokers, as will be pointed out more clearly in the chapter on "Investment and Banking Credits."

Bonds.—A bond is a promise to pay a certain definite sum of money at a fixed time in the future and a certain definite rate of interest. In the case of income bonds, however, payment of interest is contingent upon the extent of the excess earnings over and above the interest payments on all fixed-interest-bearing obligations. Another exception to the definition is that, in case of participating bonds, part of the interest payment is conditional upon the available net earnings of the issuing corporation.

Bonds may be issued by private corporations and by local, state, and Federal governments. These promises are under seal and vary in denomination from $50 to as high as $100,000. The most common denomination is $1,000. The rate of interest promised varies considerably, depending upon the nature of the security behind the instrument, the credit standing of the issuing corporation, the current rate of interest at time of issue, and the life of the security. The chief difference between bonds and promissory notes consists in the length of life of the security. Obligations maturing within five years from date of issue are generally termed notes, while those running beyond that nominal period constitute bonds.

Bonds may be classified according to the type of the issuing company, in which case they are divided into railroad, public utility, mining, and industrial bonds; or on the basis of maturity date, in which instance they are segregated into short-term bonds, medium-, and long-time obligations. Short-time bonds usually mature within 5 to 15 years from date of promise; medium-term bonds have a life of 15 to approximately 40 years; and the life of long-term securities extends beyond this period. Many of the long-term bonds mature within not less than 100 years from date of issue and a few are known to have a life of 150 years.

The average investor and credit manager, as will be shown in the chapter on "Financial Statement Analysis," is interested not so much in the length of life of a bond and the type of industry from which it originates as in the nature of the security behind it. A classification of bonds according to security is therefore submitted, on which basis bonds are divided into those specifically and directly secured by property, and those which are secured largely or entirely by the general credit of the issuing, guaranteeing, or assuming corporation. The first class may be subdivided into (1) first or senior liens, including

general first mortgage bonds, divisional mortgages, and specific direct lien bonds; (2) secondary or junior lien mortgage bonds, including second and subsequent mortgages, general and consolidated mortgage bonds, and refunding mortgage obligations; (3) collateral trust bonds; and (4) equipment trust obligations. The second class consists of (1) obligatory promises, including receivers' certificates, assumed bonds, guaranteed bonds, joint bonds, and debentures; and (2) conditional promises, comprising income bonds and participating bonds.[2]

Bonds are easily transferable by indorsement and delivery and in many instances are negotiable. They can be utilized as collateral for loans and are especially valuable when listed on an important stock exchange, due to the ready market in which they may be disposed of should need arise.

Orders to Pay

It is sometimes argued that, nothwithstanding the fact that checks, bank notes, and all sorts of drafts payable on demand are commonly recognized as credit instruments, they are strictly not credit instruments at all. The basis for this contention is that they are not evidences of deferred or postponed payment, which is an essential characteristic of all credit transactions. Thus, the argument runs, a check, for example, is a credit instrument only in the sense that it must be honored by the bank before it becomes equivalent to cash; that there is no more credit involved in a transaction involving payment by check than there is in an ordinary cash operation when a brief interval elapses between the passing of the goods to the customer and receiving the money from him; and that neither of these transactions are really regarded in practice as credit transactions, because neither involves a deferred payment.[3]

Obviously, the analogy drawn between a cash transaction and one involving payment by check is far from satisfactory. Although the interval between the transfer of the goods and receipt of payment in cash is very brief in both instances, nevertheless the former involves no risk or confidence, depending upon the way in which it is viewed, whereas the acceptance of the check must be approved by the credit manager or some other responsible executive. It is interesting to note in this connection that

[2] Dewing, A. S., "Financial Policy of Corporations," vol. 1, p. 41.

[3] Moulton, H. G., "The Financial Organization of Society," pp. 164–168.

worthless checks cashed by merchants cost them annually no less than $100,000,000 and that, when forgery is included, another $25,000,000 loss may be added to this figure.[4]

The matter of accepting checks in payment for goods purchased has become so serious, because of the enormous losses incident thereto, that many merchants have inaugurated a policy of accepting only cash or of limiting the amount of a check to be accepted from any one individual, as well as confining such practice to the hours when checks can be verified by banks over the telephone. The acceptance of a check, unless it be small in amount, is directly contingent upon the confidence which a merchant has (1) that the maker has the requisite funds to his credit in the bank on which the instrument is drawn, and (2) that it will be honored by the bank. Even where checks are certified or signed by the cashier, confidence must be had in the bank's ability to pay upon presentation. To be sure, the soundness of our banking system has caused these checks, as well as bank notes and bank drafts, to become as satisfactory a means of payment as actual cash. But is not this merely the result of increased confidence to a point where all risk is practically eliminated *under ordinary conditions?* No one can effectively deny the fact that all of these instruments do involve a certain element of futurity. They are all credit instruments in form, and promise directly or by implication to pay cash upon demand. And because of this element of postponed payment, though it be brief, there is a certain amount of risk involved, which may be reduced to a minimum by virtue of sound legal and banking systems, that the instrument may not be convertible into cash. And whenever a doubt arises as to the possibility of conversion, as *it has arisen in the past,* the *difference* between such instruments and standard money is revealed.

Checks.—Of the forms of credit instruments termed "orders to pay," the most generally used and, therefore, the most important is the check. It is a written order by a depositor on his bank, directing the bank to pay at sight a certain sum of money to himself or to order of some person or firm named thereon (Fig. 2). Legally, checks are defined as drafts drawn on a bank, payable on demand.

[4] GETZ, C. H., "Cashing Checks for Strangers Costs $25,000,000 a Year," *Bankers' Monthly,* May, 1923, p. 11.

The popularity of the check may be accounted for by the convenience it affords. While promissory notes and drafts are used for long-time payments, checks are employed for cash and immediate settlements. It is the most popular substitute for media of exchange and its use is still on the increase, due, undoubtedly, to the development of banking facilities and thrift on the part of the lower income-producing strata of society. Final payment in the wholesale trade is almost invariably made by check, and the tendency on the part of consumers to adopt a similar practice is continuously growing.

Checks are negotiable instruments, are readily transferable, and one check may, because of its free circulation, be used in the cancellation of many obligations. It facilitates payment not only locally, but also between debtors and creditors geographically far removed from one another.

FIG. 2.—Bank check.

Certified and Cashier's Checks.—When payment is to be made where the depositor is not known or when goods are purchased on C.O.D. terms, and the depositor wishes to establish the fact that he has sufficient funds in the bank upon which the instrument is drawn and that the check will be honored, one of two devices may be employed. The depositor may have the bank certify the check, in which instance the word "Certified," "Good," or its equivalent is stamped across the face of the instrument and the certification initialed by the bank teller or cashier. The certification adds to the value of the check, because payment is guaranteed by the bank and the check becomes the bank's promise to pay.

Another method open to the depositor is to use the cashier's check. The cashier's check is an order on a bank, signed by the

cashier, payable to the person or firm designated by the depositor.

In both instances, the amount of the check is charged ultimately to the depositor's account, thereby eliminating all danger incident to lack of sufficient funds. When a bank refuses to honor an ordinary check because of insufficient funds, the check not only becomes the direct promise of the maker and the direct obligation of all but the qualified indorsers, but also makes the maker liable to punishment under the Bad Check Law.

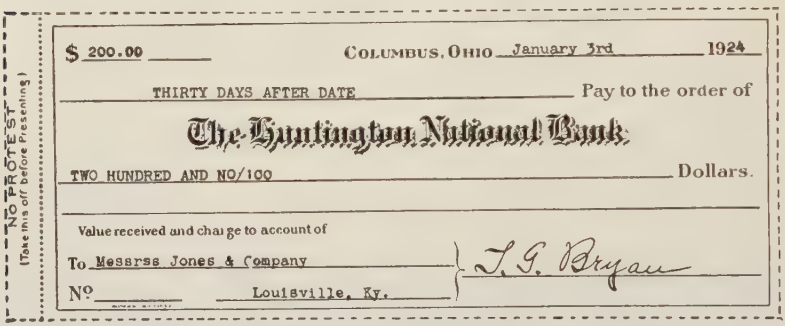
Bad Check Law.—The purpose of the Bad Check Law, or, as it is frequently labeled, the "Not Good Check Law," is to prevent and eliminate ultimately the pernicious practice of issuing and negotiating worthless checks, with intent to defraud. All but three states have enacted laws defining the crime involved in issuing checks under such circumstances and providing appropriate punishment.[5]

Under most of these statutes the mere non-payment of a check constitutes evidence of intent to defraud, and of knowledge of insufficient funds or credit at the bank. The presumption of fraudulent intent, however, is rebutted by payment to the holder by the maker or drawer of the face amount of the check plus costs and protest fees, usually within ten days after receiving notice of dishonor, with reason therefor. On this account the law has been severely criticized, because it apparently gives a person an opportunity to condone his crime. The criticism is nevertheless unsound, for the crime exists, even though the amount due on such check is repaid and made good. This payment merely restores to the maker the common law presumption of innocence with respect to intent to defraud and knowledge of insufficient funds or credit at the bank, and places the burden of proof on the state.

The principal reason for the exceedingly small number of convictions under these statutes is the difficulty in enforcing the law, since it is necessary to prove the existence of criminal intent at the time the act was committed before conviction can be obtained. Insufficiency of funds and dishonor of the check merely constitute *prima facie* evidence of an intent to defraud, but such presumption, as already pointed out, could be rebutted by payment of the amount due and by a direct denial, under

[5] The three states referred to are Delaware, New Hampshire, and New Mexico.

oath, of such intent on part of the maker, thereby leaving the burden of proof to the state. In this lies the chief weakness of the Bad Check Laws, since they have for this reason failed to furnish mercantile creditors that degree of protection from the abuse which was anticipated would result from the campaign conducted by the National Association of Credit Men and other interested organizations.


NO PROTEST
(Take this off before Presenting)

$ 200.00 COLUMBUS, OHIO January 3rd 1924

THIRTY DAYS AFTER DATE Pay to the order of

The Huntington National Bank

TWO HUNDRED AND NO/100 Dollars.

Value received and charge to account of

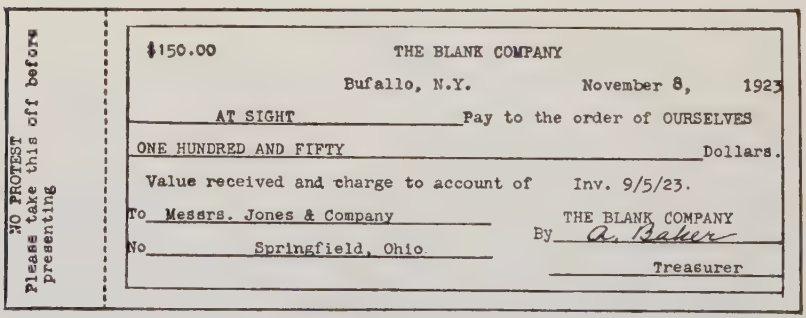
To Messrs Jones & Company

No. Louisville, Ky.

L. G. Bryan

FIG. 3.—Commercial draft.

Drafts.—A draft is a written order by one party on a second party to pay to a third party a certain amount of money at sight or at a fixed time in the future. There are three parties to every draft: the drawer, drawee, and the payee. Drawer and payee, however, may be the same person or firm (see Figs. 3 and 4).


NO PROTEST
Please take this off before presenting

$150.00 THE BLANK COMPANY

Bufallo, N.Y. November 8, 1923

AT SIGHT Pay to the order of OURSELVES

ONE HUNDRED AND FIFTY Dollars.

Value received and charge to account of Inv. 9/5/23.

To Messrs. Jones & Company

No Springfield, Ohio.

THE BLANK COMPANY

By A. Baker

Treasurer

FIG. 4.—Common form of commercial draft.

Classification of Drafts.—Drafts may be classified according to date of payment, the character of the drawee, place where the parties reside, whether the draft is accepted or not, and whether it is free or documented.

Following the first basis, these credit instruments are divided into sight drafts and time drafts. The former are payable on presentation or a specified number of days after sight. Express and postal money orders are examples of this kind of drafts. Time drafts are payable a stated number of days after date.

According to the character of the drawee, drafts are divided into commercial and bank types. The former are drawn by one merchant on another, while the latter are drawn by one bank on another.

Drafts are also divided on the basis of the places wherein the parties reside. This classification gives rise to domestic drafts, as when the parties reside within the United States, and foreign drafts, commonly known as bills of exchange.

Again, drafts may be classified into ordinary and "accepted." The "accepted" instruments may, in turn, be divided into "trade acceptances" and "bank acceptances."

Finally, drafts may be documented, as when bills of lading or other papers, such as warehouse receipts, are attached, giving title to the goods involved upon acceptance or payment of the draft. Undocumented instruments are free or clean drafts.

Express and Postal Money Orders.—These instruments resemble very closely checks and bank drafts. A postal money order, for instance, is an order issued by one post office on another, requiring the payment of the amount specified therein to the person designated in the instrument, or to his order. The maximum amount for which a single money order may be issued in the United States is $100. When larger sums are to be sent, additional orders may be obtained, since no limitation is placed on the number of orders which may be drawn on any office on any one day. The rates vary from 3 to 30 cents, depending upon the amount of the order.

As in case of checks and bank drafts, the function of express and postal money orders is to transfer money to someone at a distance. They are purchased by the debtor, made payable to the person or firm specified on the face of the instrument, and are forwarded by mail to the payee. In case of postal money orders, the payee receives payment upon presentation of the instrument to the nearest post office. Express money orders may be cashed at the banks. Neither of these credit forms have to be returned to the place of the debtor before final payment; hence their superiority over ordinary checks.

Bank Drafts.—A bank draft is an order of one bank on another in which it has deposits or credit relations to pay a certain sum of money to a person or firm named in the draft. These drafts are used to facilitate the making of distant payments. This method of payment does not require drafts to be returned to the place of the drawer bank for final payment. It also facilitates personal traveling, through the reduction of risks incident to transferring money to places where it is desired by depositors.

Bills of Exchange.—"A bill of exchange is an unconditional order in writing addressed by one person to another, signed by the giver, ordering the person to whom it is addressed to pay on demand or at a fixed or determinable future time a certain sum of money to order or to bearer." The payee may be the drawer of the bill or a creditor of the drawer. In each instance the drawer's account is debited with the amount paid.

These credit instruments are used extensively in the settlement of debts arising from foreign trade. Since the occasion that gives rise to such a draft consists in a business transaction, it is regarded a comparatively safe form of credit. The common procedure followed in making settlement by the use of bills of exchange is for the seller of merchandise to draw upon the buyer, attach the draft to the various documents denoting shipment, and sell or discount the instrument at his local bank. This bank soon forwards the draft, with the documents attached, to its correspondent bank in the country of the buyer. The draft is then presented by the correspondent bank to the drawee for collection or acceptance, depending upon whether it is a sight draft or a time draft. If a time draft, it is accepted, and may then be sold to investors or other bankers until it becomes due.

Trade Acceptances.—A trade acceptance is a time draft or bill of exchange accepted by the purchaser or drawee by signing his name under the word "Accepted" across the face of the draft. The date of acceptance and the bank at which it is payable, together with the place of payment, are also commonly stated on the face of the instrument. Another difference between a trade acceptance and a commercial draft is that the former has on its face the following statement: "The obligation of the acceptor hereof arises out of the purchase of goods from the drawer," etc. (Fig. 5).

Trade acceptances minimize the risk involved in the handling of commercial paper. The increased use of this form of credit will effect a substitution of double-name for single-name paper. Then the banks are able to rediscount this commercial paper, to which the principle of self-liquidation so aptly applies, which is, in turn, utilized by the Federal Reserve Bank as a basis for the issue of Federal Reserve notes. Furthermore, trade acceptances are regarded as a good investment by banking institutions.

Because of the supposed willingness on the part of bankers to deal in them, trade acceptances should be readily discounted by the seller of merchandise. In doing so, the seller is not obliged to furnish the banks such a "cushion" or margin of safety as would be required when open book accounts are assigned. Immediate possession of funds from a sale of goods enables the

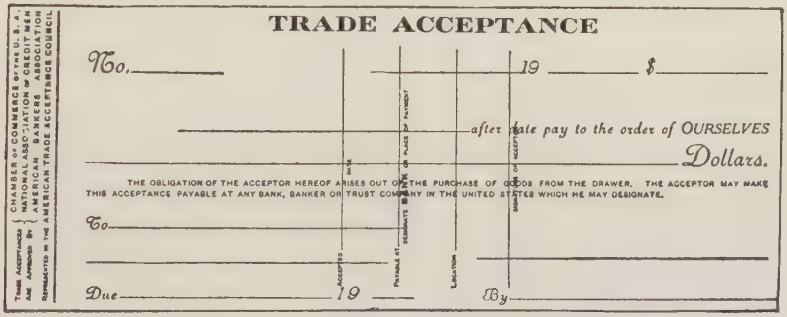

TRADE ACCEPTANCE
No.
19
$
after date pay to the order of OURSELVES
Dollars.
THE OBLIGATION OF THE ACCEPTOR HEREOF ARISES OUT OF THE PURCHASE OF GOODS FROM THE DRAWER. THE ACCEPTOR MAY MAKE THIS ACCEPTANCE PAYABLE AT ANY BANK, BANKER OR TRUST COMPANY IN THE UNITED STATES WHICH HE MAY DESIGNATE.
To
Due
19
By
ACCEPTED
PAYABLE AT
LOCATION
BANK OF PLACE OF PAYMENT
DATE OF ACCEPTANCE
This Acceptance { Is Approved by / Are Approved by } CHAMBER OF COMMERCE OF THE U. S. A. NATIONAL ASSOCIATION OF CREDIT MEN AMERICAN BANKERS ASSOCIATION
Represented in the AMERICAN TRADE ACCEPTANCE COUNCIL

FIG. 5.—Trade acceptance in domestic commerce.

merchant to operate with a smaller capital investment, which he can turn rapidly and thereby reduce his cost of doing business. Furthermore, all questions pertaining to the taking of uncarned discounts are at once completely removed. By admitting the correctness of the amount, the buyer is precluded from setting up any grievances or controversies to which a seller is normally subject when the mere evidence of the debt is an open book account. There is likely to result a diminution in the tendency to return merchandise, an evil which in some trades has already assumed enormous proportions. Above all, the growing use of trade acceptances in the settlement of debts will tend to reduce the employment of open book accounts, thereby placing credits on a higher moral plane.

The general adoption of trade acceptances is not without its objectionable features from the standpoint of sellers. In dis-

counting a trade acceptance at his bank, the seller must indorse it. This means that the merchant, by becoming an indorser for all of his customers, is contingently liable for all of their purchases from his house. Then, too, there is a tendency to convert customers who discount their bills into buyers by acceptance, the net result of which is to lengthen the credit period unduly. Lastly, it is said that payment for goods before they are received, as necessitated by the acceptance method of settlement, will tend to influence buyers to trade with the larger and more reliable houses, and thus eventually crowd out the smaller competing concerns.

From the standpoint of the purchaser, the trade acceptance offers some very important advantages. It makes it possible for the "time" buyer to purchase practically at "cash" prices. The weaker buyer is thereby placed on the same footing with those who generally discount their bills. Of course, this statement is based on the assumption that the widespread use of trade acceptances will ultimately eliminate entirely the use of cash discounts, which is hardly probable. By promptly discharging his obligations, as represented by trade acceptances, the buyer will improve his credit standing at his bank. In order to be able to meet his obligations promptly, the buyer will also have to exercise care and caution so as to avoid putting out more paper than can be taken care of. This will do two things for the purchaser: it will cause him to be more conservative in his buying and avoid the danger of overloading with an unsalable stock of goods; secondly, it will tend to make him a better collector and more conservative in credit granting.

To be sure, some objections are raised on the part of buyers, primarily because the use of the acceptance method does not permit them to examine the goods before payment is made. A similar condition obtains, however, when goods are purchased on cash terms, or when the discount is to be taken advantage of by paying within ten days from date of invoice and the goods are longer in transit. In all of these cases, sufficient confidence must be placed in the seller's willingness to make adjustments and to heed just and reasonable claims. Another objection raised to the trade acceptance is that it removes profits from discounts on purchases offered for prompt payment of bills. This objection is particularly valid from the standpoint of buyers who are financially stronger than their competitors.

On the whole, the use of trade acceptances has not increased as rapidly as may be desired. In many instances some of the advantages claimed for trade acceptances have not materialized. When numerous small invoices are involved, it is more convenient to carry an open account. Many buyers find it more advantageous to borrow from their local banks funds with which to discount their bills. The most important reason, however, for the limited use of trade acceptances is probably the reluctance of merchants to change their habits of doing business.

Bank Acceptances.—A bank acceptance is a draft drawn upon a bank by a depositor or borrower, payable to a third party and accepted by the drawee. This instrument may be used advantageously by a buyer who wishes to buy on a cash basis

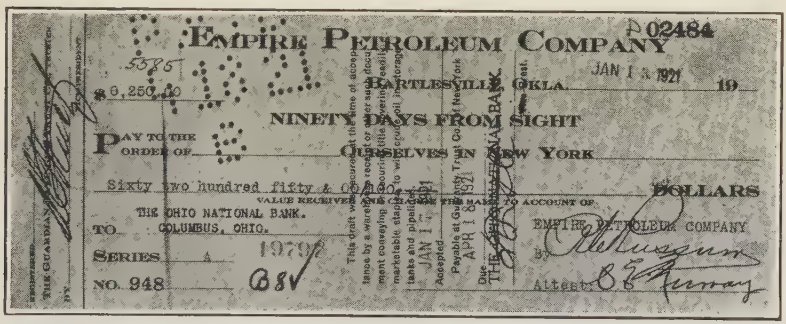


FIG. 6.—Bank acceptance secured by readily marketable staples.

but is unwilling to make payment until the goods are shipped, or until they have actually arrived. On the other hand, the seller may be unwilling to make shipment on an open account or upon a time draft, except at a great discount which is reflected in higher prices. Both parties may then be satisfied by the buyer having his bank pledge itself to accept and pay the seller's draft, provided all the terms of the transaction have been complied with. The buyer then makes arrangements with his bank to take care of his obligation on the due date. He thus secures a loan at a much lower rate than could be obtained otherwise.[6]

Bank acceptances may also be used for borrowing purposes in the general discount market. Thus, merchants or producers may store their products with a properly organized warehouse, deposit the warehouse receipt as security, and obtain the accept-

[6] FITZGERALD, J. A., "Making Use of a Bank," pp. 218–219.

ance of a reliable bank. When thus accepted, a drawer can then sell his bills in the open market at the lowest rate of interest (see Figs. 6 and 7).

Travelers' Checks.—These checks can be obtained at practically every bank. They are issued in four denominations ($10, $20, $50, and $100) and can be made up in any amount in book form, from which they may be torn as occasion requires. Travelers' checks are used for long-distance travel among strangers where the carrying of much gold or currency is unsafe. By the use of these instruments funds may be easily secured. All that is needed is to establish one's identity by signing one's name, which is then compared with the signature appearing on each check.

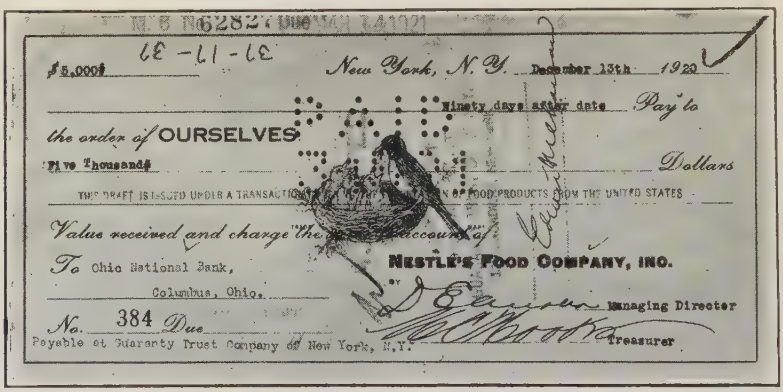


FIG. 7.—Bank acceptance covering an export transaction.

Travelers' Letters of Credit.—A traveler can also secure from his bank a letter of credit. A traveler's letter of credit may be defined as a request from a banker or firm to other banks or firms, with whom the former has credit relations or deposits, to advance money not exceeding the face value of the letter to the person named therein. It is the bank's agreement to accept the drafts of the traveler up to the face value of the letter, which is to be returned with the last draft. Its chief function is to facilitate the transfer of funds to foreign countries for the convenience of travelers. The purchaser of such an instrument has the right to draw at different times from different banks or firms up to the amount stated in the letter (see Fig. 8).

Each time a sum of money is drawn by the holder of the

letter, the instrument is presented to the official making payment. He then notes on the reverse side of the letter the date when paid, by whom paid, and the amount drawn. The holder

FIRST WISCONSIN NATIONAL BANK

OF MILWAUKEE

CIRCULAR LETTER OF CREDIT

$

No. 00000 MILWAUKEE

TO OUR CORRESPONDENTS:

GENTLEMEN:

WE INTRODUCE TO YOU

WHOM WE HEREBY AUTHORIZE TO DRAW UPON US OR UPON
THE AMERICAN EXCHANGE NATIONAL BANK, NEW YORK CITY,
AT SIGHT, TO THE ACCREDITED AMOUNT OF

DOLLARS U.S.

EACH DRAFT MUST BE PLAINLY DATED AND BEAR THE NUMBER UNDER THIS CIRCULAR LETTER OF CREDIT No. 00000 OF THE FIRST WISCONSIN NATIONAL BANK OF MILWAUKEE AND THE PARTICULARS THEREOF MUST BE ENDORSED HEREON.

YOUR NEGOTIATION OF A DRAFT SHALL BE YOUR GUARANTEE THAT THE REQUIRED ENDORSEMENT WAS MADE.

DRAFTS MUST BE PRESENTED IN YOUR PRESENCE AND CAREFULLY COMPARED WITH THE SIGNATURE IN THE ACCOMPANYING BOOK OF INDICATION.

WE HEREBY ENGAGE THAT DRAFTS DRAWN IN ACCORDANCE WITH THE CONDITIONS HEREOF SHALL BE DULY HONORED IF NEGOTIATED ON OR BEFORE

THIS LETTER OF CREDIT AND THE ACCOMPANYING BOOK OF INDICATION MUST BE SURRENDERED AND CANCELED AND ATTACHED TO THE LAST DRAFT DRAWN HEREUNDER.

YOURS FAITHFULLY,

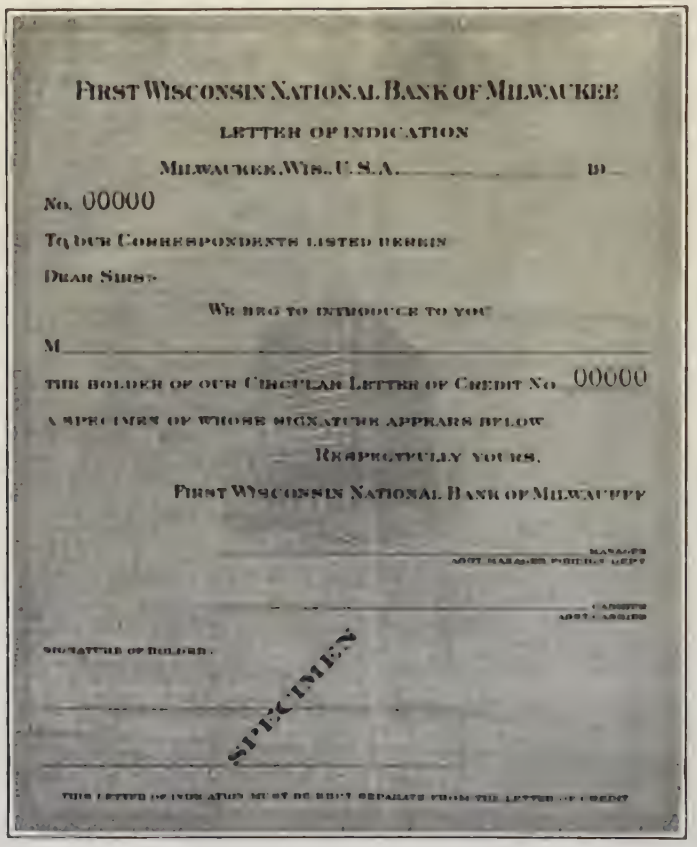
FIRST WISCONSIN NATIONAL BANK OF MILWAUKEE

FIG. 8.—Travelers' letter of credit.

is also required to sign his name on a separate piece of paper so that his signature may be identified, by comparison, with that appearing on the letter of indication which is attached to the

accompanying Book of Indication, in which are listed the names of all correspondents of the issuing bank (see Fig. 9).

Most travelers' letters of credit are made payable in London. If the traveler is in Berlin and finds himself in need of funds, he goes to a bank specified in the letter and identifies himself.



FIRST WISCONSIN NATIONAL BANK OF MILWAUKEE

LETTER OF INDICATION

MILWAUKEE, WIS., U. S. A. _____ 19__

No. 00000

TO OUR CORRESPONDENTS LISTED HEREIN

DEAR SIRS:

WE BEG TO INTRODUCE TO YOU

M_____

THE HOLDER OF OUR CIRCULAR LETTER OF CREDIT No. 00000

A SPECIMEN OF WHOSE SIGNATURE APPEARS BELOW

RESPECTFULLY YOURS,

FIRST WISCONSIN NATIONAL BANK OF MILWAUKEE

_____ MANAGER

_____ ASST. MANAGER FOREIGN DEPT.

_____ CASHIER

_____ ASST. CASHIER

SIGNATURE OF HOLDER

_____

SPECIMEN

_____

THIS LETTER OF INDICATION MUST BE KEPT SEPARATE FROM THE LETTER OF CREDIT

FIG. 9.—Letter of indication which must be presented each time a draft is drawn under the traveler's letter of credit.

The bank ascertains the price of pounds sterling at the time, and draws a draft for enough pounds to equal the number of marks desired by the holder of the letter. This draft is then forwarded to London by the Berlin bank, and proper notation is made on the reverse side of the letter of credit, which is then returned to the traveler, together with the desired amount of money. The London bank then charges the issuing bank's

account with the amount of the draft and forwards it to that bank. If the draft exhausts the letter of credit, the latter is retained by the Berlin bank and returned through the proper channels to the issuing bank.

Commercial Letters of Credit.—A commercial letter of credit is defined as "a guarantee of payment, or a promise in writing on the part of a bank, to pay to a designated beneficiary a certain sum of money under specified conditions."[7] It is an instrument usually issued by the foreign department of a bank to an importer to facilitate financing of importations. The letter of credit specifies a maximum amount of credit, the quantity and quality of goods to be purchased, the time within which shipment must be made, full instructions as to the shipment, the drawing of the draft, and the disposition that should be made of the documents. One copy is retained by the issuing bank, one is given to the buyer, and the original is sent to the foreign exporter or shipper. The shipper then presents the instrument, with the shipping documents and draft attached, to his local banker. The local banker negotiates the draft and thereupon forwards it, together with the documents, to the bank which issued the letter of credit, through his correspondent bank. If it is a time draft, the issuing bank accepts it, and if a sight draft payable on demand, it pays the amount involved. In each instance the shipping documents are surrendered to the issuing bank.

The documents which are usually specified in the letter of credit, and which must be presented to the bank to secure payment, consist of shipper's invoice in triplicate; consular invoice, when required; insurance policy or insurance certificates in duplicate; certificate of origin, when required; packing lists in duplicate; and a full set of ocean steamer bills of lading.

The importer finally secures the documents from his banker in exchange for a trust receipt executed by him whereby the banker is given a first lien on the merchandise until payment has been made on or before maturity of the accepted draft. If a sight draft, the importer is expected to reimburse his banker before the shipping documents are surrendered, unless arrangements are made with the bank for a loan of the amount for an extended period. Under the trust receipt the importer binds himself to hold the goods in trust, keep them insured in favor

[7] Poole, G. C., "Export Credits and Collections," p. 75.

of the bank, and to turn over all proceeds, from the goods sold, to the banker until the full amount involved is repaid, when the trust receipt is surrendered.

LETTER OF CREDIT.

THE BRITISH BANK OF SOUTH AMERICA, Limited,
LONDON.

No.....

NEW YORK, ...

.....

.....

DEAR SIRS:

You are hereby authorized to value upon THE BRITISH BANK OF SOUTH AMERICA, LTD., LONDON,

at.....for account of

.....

for any sum or sums not exceeding.....

for cost of..... to be shipped from.....

to.....on board any vessel or vessels.

The Bills of Lading must be made out to the order of THE BRITISH BANK OF SOUTH AMERICA, LTD., and two of such Bills of Lading, together with invoice properly certified, must be forwarded to THE BANK OF NEW YORK, N. B. A., NEW YORK, by the vessel bringing the goods.

The shipments must be completed and the Bills of Exchange drawn..... from this date. All drafts under this credit, when presented for acceptance, must be accompanied by one Bill of Lading and abstract of invoice, and advice of all drafts must be sent direct to the drawees. Insurance to be effected in the United States.

And THE BRITISH BANK OF SOUTH AMERICA, LTD., hereby agree with the drawers, endorsers and *bona fide* holders of bills drawn in compliance with the terms of this credit, that the same shall be duly honored on presentation at their counting-house.

For THE BRITISH BANK OF SOUTH AMERICA, LIMITED,
THE BANK OF NEW YORK, N. B. A., Attorney,

By.....

For £.....

.....
Assistant Cashier.

Please sign Bills as being drawn under Credit No......
and have each Bill endorsed hereon at the time of drawing.

Dated.....

FIG. 10.—Commercial letter of credit.

Letters of credit may be confirmed and irrevocable, unconfirmed and irrevocable, or unconfirmed and revocable. Some letters of credit may not be confirmed either because no request is made to that effect by the issuing bank or because the credit

relations with the correspondent bank which is to confirm the letter may be such as not to warrant confirmation, for the effect of such action by the correspondent bank is virtually to extend credit to the issuing bank for the amount involved. If the issuing bank reserves the right to withdraw the credit at any time at its option, the letter of credit is known to be revocable. On the other hand, if the terms stipulate that the credit may not be withdrawn, at least prior to a given date, the letter is said to be irrevocable.

Confirmed and irrevocable letters of credit afford the greatest security to the seller, because they represent an obligation of two banks and cannot be withdrawn until payment has been made in accordance with the provisions therein. Unconfirmed and irrevocable letters of credit are safe only to the extent to which the issuing bank is responsible financially. Unconfirmed and revocable letters are the poorest from the standpoint of safety to the seller and should not be accepted by him unless full confidence is placed in the reputation and financial responsibility of the importer and the issuing bank.

It should be observed that the credit extended in the form of commercial letters of credit is secured solely by the merchandise imported. It is, therefore, essential that the goods be properly handled, well insured, and otherwise taken good care of. To avoid fraud on the part of the exporter and to guard against inability of the importer to meet his obligations at maturity, the issuing banker requires the purchaser of a letter of credit to sign an agreement to the effect that the terms of the contract will be closely observed and that, in case of depreciation in the value of the goods while in transit, he will furnish additional security as may be required of him, and that, in default thereof, the banker is given the right to dispose of the merchandise, irrespective of the maturity of the drafts drawn under the letter of credit (see Fig. 10).

CERTIFICATES OF OWNERSHIP

Gold certificates, silver certificates, warehouse receipts, stocks, and stockholders' "rights" are sometimes included among credit instruments. Although used as such, they are not to be considered credit instruments at all, for they merely represent ownership on the part of their respective holders. One of the

important characteristics of credit instruments is the divided equity or ownership which they bring about, in which case the user of the property is separate and distinct from its owner. Thus, the user of a house which is mortgaged remains its owner only as long as the requirements of the mortgage are fulfilled, and the house technically and legally belongs to the mortgagee, at least provisionally. A similar situation obtains when merchandise is sold on an open book account or on the basis of a draft or promissory note. The possessor or user of the merchandise is separate from its technical owner or creditor, and the equity in the goods is, therefore, divided. On the other hand, certificates of ownership merely constitute evidences that certain property is owned by the holder thereof, who has seen fit to place such property in custody of certain responsible persons or institutions. There is no postponement of payment involved, for the property deposited for safe keeping or management may be withdrawn at will, except, of course, in case of stockholders, where it is necessary that all act in unison in order to bring about a dissolution and liquidation; technically speaking, therefore, the principle applies even to stocks, which represent joint ownership, consequently requiring the consent of at least a majority in order to effect desired results.

Stocks.—Because of their peculiar characteristics, stocks call for further treatment. A share of stock represents a partnership right to participate in the earnings of the issuing company and in the amount of money or property received upon liquidation, according to priority. It is a certificate of ownership in the issuing corporation. Each share of stock is entitled, in case of liquidation or upon declaration of dividends, to a proportional share of the equity behind the total issue of which it constitutes a part.

There are two principal classes of stock, preferred and common. A preferred stock represents a particular portion of the shares, having certain preferences and limitations. The nature and extent of the privileges and limitations with which they are endowed are determined in each particular case. A preferred stock differs from a common share only to the extent to which such differences are definitely and specifically stated in the provisions of the charter and by-laws of the corporation. Preferred stocks may be preferred as to assets or as to dividends,

or both; is usually made non-voting; includes many protective provisions; and is ordinarily limited as to the amount it may receive in dividends, which, again, may be cumulative or non-cumulative. It should be borne in mind that a preferred stock is identical with the common stock in every respect, except to the extent of definite provisions to the contrary, by means of which it is endowed with special rights and limitations.

When viewed from one angle, a stockholder is a creditor and stocks are credit instruments. According to law, a corporation is an entity; it can sue and be sued in its own name. Again, from the economic viewpoint, a corporation may be considered an organization separate and distinct from its stockholders and bondholders. Frequently, stockholders take no more active interest in the business than the other security holders and merchandise creditors, particularly in the large corporations, so that even in practice the business is virtually divorced from its legal owners. Therefore, it is argued, stockholders are in a sense creditors and stocks are forms of credit. Besides, certificates of stock are negotiable and readily salable by indorsement and delivery the same as are bonds and promissory notes. They are also frequently put up as security for loans at the banks, and are particularly valuable when listed on an important stock exchange and actively traded in.

From another standpoint, however, stocks must not be considered credit instruments. They are but certificates of ownership. Legally, again, a stockholder is a part owner of the issuing corporation. He cannot enforce claims against the corporation either for dividends (unless they have already been declared) or principal so long as the company remains a going concern, unless it can be proved that fraud or unbusiness-like methods have been exercised on the part of the board of directors. This is so because the board of directors serves in a fiduciary capacity for the stockholders to whom they are responsible or, rather, accountable for the manner in which the property is handled. It appears, therefore, that, although from many angles stocks partake of the features characterizing credit instruments, they are nevertheless, in reality, but evidences of ownership involving no postponement of payment so long as the company remains a going concern.

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CHAPTER III

INVESTMENT AND BANKING CREDITS

All credits may be grouped under two principal heads, public and private. These, in turn, are subdivided in different ways, depending upon the respective bases employed. In the following pages the discussion will be entirely confined to private credit, which is divided for our purposes into investment, banking, retail or personal, and mercantile credits.

INVESTMENT CREDIT

At its inception, as well as thereafter, a business enterprise requires three classes of credit: investment, banking, and mercantile. Investment credit is utilized for the purpose of obtaining funds with which to purchase and acquire fixed assets, such as land, buildings, machinery, fixtures, delivery equipment, and intangible assets of a more or less permanent character. A sufficient amount must also be provided in this manner for the working capital which a concern requires in its normal condition of business activity. Permanent working capital is that portion of the funds of a business which is constantly needed from week to week and from month to month. It is the sum required to carry minimum inventories of merchandise and supplies.

Characteristics of Investment Credit.—Investment credit is obtained through the issue of relatively long-term obligations. These obligations take the form of bonds, real estate mortgages, equipment obligations, and long-term notes of individuals or firms. They are promises to pay definite sums of principal and in most cases also certain rates of interest. Stocks and shares in joint-stock companies, which are merely evidences of ownership or partnership rights to participate proportionally in the residual equity of the business enterprise, are used practically in the same way. These loans are made purely for investment purposes, hence the term "investment credit." The money ob-

tained in either of the forms enumerated is permanently or for a relatively long period of time invested in the business.

Sources of Investment Credit.—Four principal sources are available from which investment credit may be secured. The chief source is the ultimate individual investor, of whom there are numerous gradations. These are individuals who have saved, inherited, or married wealth. Instead of hoarding or engaging in business primarily for the purpose of utilizing these funds, they are invested in long-time securities. Hoarding is both insecure and profitless. Funds may be destroyed by fire or stolen, and if insured against these contingencies, additional expenses are incurred. Again, many individuals possessing wealth are either unwilling or incapable of actively managing their own business. Accordingly, these persons are constantly searching for places where their funds can be invested so as to bring a fair return and where the principal will at the same time remain secure.

Some of the ultimate individual investors are interested primarily in securities of an investment character, namely, obligations which bring a steady return and the prices of which do not fluctuate to any considerable extent. The income on such securities is usually low, since, as a rule, security of principal and a high rate of return are incompatible. On the other hand, a great many investors are attracted by promises of high rates of return. These are interested in speculative securities the prices of which fluctuate frequently and violently and from which income may be high at times. Many persons are anxious to invest in them also in the hope of their appreciation in value. Between the two extremes, we find numerous types of individual investors seeking different combinations of security, maturity, and rate of return. This is why so many different types of bonds and stocks have come into existence, all for the purpose of satisfying the whims and fancies of the investing public and thereby widening the market for the securities.

A second class of investors in long-term obligations are trustees of funds of individuals and estates. Funds of deceased persons are thus invested by the trustees for the benefit of the beneficiaries. In this class are also to be included investments of educational and eleemosynary institutions.

Insurance companies constitute another class of heavy purchasers of investment securities. They are primarily interested

in high-grade obligations the prices of which lack the nervousness attending the more speculative securities and the marketability of which is well assured. It is thus possible to put the surplus funds and part of the reserves to work, thereby enhancing the profitability of the enterprise.

Finally, banking institutions commonly invest in long-time securities. Certain savings banks operating on a non-profit basis invest the funds for their depositors in this manner. The same situation obtains in case of investment in real estate mortgages on the part of building and loan associations and the like. Although most of the high-grade bonds and stocks pass through the hands of investment bankers, they are nevertheless excluded from among the sources of investment credit. They are merely middlemen, standing between the issuers of the securities on the one hand and the ultimate investors on the other.

BANKING CREDIT

Definition.—Banking credit is the power which enables commercial banking institutions to attract the funds of depositors and to make loans and create obligations, payable on demand, which are not backed by a 100 per cent cash reserve. The credit granted by a commercial bank to an individual or firm is generally in the form of short-term loans. The length of the credit period usually varies from 30 to 90 days, since only those notes which mature within 90 days can be rediscounted by banks, with the exception of paper used for agricultural purposes or that arising out of foreign trade transactions. In these cases a period of six months is allowed for rediscounting purposes by Federal Reserve Banks. Commercial bankers, nevertheless, occasionally accept notes maturing within more than the stated period.

The purpose of credit extended by banks is to help a concern, whose business is subject to seasonal variations, carry the peak of the load at the time the business is paying for its purchases and waiting for remittance from its customers. Banking credit also furnishes a means of taking advantage of cash discounts through the payment of bills before due with the proceeds obtained therefrom.

Development of Bank Credit Work.—Were a census taken of all the commercial banking houses in the country, it is believed that relatively few would be found to have complete and

up-to-date credit departments. Yet practically every institutional bank is in some way performing the services a credit department is designed to render. In numerous instances, the cashier or his assistant is combining credit work with his other functions. This is especially true of the smaller banks with a limited clientele and banking institutions in smaller communities. Hardly a bank, irrespective of size, can successfully operate without full credit data concerning its customers and prospects. Every commercial bank has three distinct functions to perform: first, to secure money on deposit in exchange for its credit sold to depositors; second, to make loans or lend its credit, and discount commercial paper through an exchange of its credit for that of the merchant giving the paper; and, third, to watch the funds while they are working.

A bank's credit department is charged primarily with the performance of the third function and in addition exercises considerable power with respect to the second. Concretely, a bank's credit department has as its duty to investigate the credit standing of applicants for credit. Some institutions have even gone so far as to require their credit departments to carry on investigations concerning prospects prior to soliciting their accounts. These are still in the minority, for in most banks no investigations are undertaken until an application for credit is formally made.

The next most important service rendered by the bank's credit department is that of keeping the officers of the organization informed as to the standing of its borrowing customers. Credit files are frequently revised and changes in customers' standing noted. Additional information concerning risks is constantly pouring into the credit department from many and varied sources. These additional facts may prove favorable or unfavorable. If the former obtains, it might be advisable to increase the customer's credit limit when requested or at least to continue the account on the existing basis and remove all doubt that might have existed in the minds of the bank's officials concerning the risk involved. If the latter is true, it may be good policy either to discontinue the account, decrease the credit limit, or confidentially review the situation with the customer in the hope of extricating him from his financial difficulties. In all of these cases, the credit department is looked

to for the necessary data required to guide the officers or the board of directors properly in their decisions.

A third service rendered by the credit department is to furnish correspondent banks with credit information in response to inquiries concerning names in which they are interested. And, lastly, the credit department must reciprocate with credit departments of other banks and commercial houses in the giving of credit information. As will be pointed out in another connection, banks are considered one of the important sources of credit information by merchants, and in some communities they constitute the only means of gaining some degree of knowledge pertaining to customers located therein.

The problem of gathering the necessary credit facts and properly keeping them is none too simple. To be sure, no elaborate systems or special records need be kept in the small banks. Here the cashier may know personally all of his customers and may, in addition, possess a substantial degree of knowledge of local conditions affecting their credit standing. With the growth of cities, size of deposits, and number of borrowers, personal contact can no longer be relied upon. The work then requires careful and sometimes minute subdivision, and memory becomes inadequate. An up-to-date credit department which collects all the necessary credit information and properly files it thus becomes a necessity, without which the functions a bank is called upon to perform cannot be effectively discharged.

Importance of Bank Credit Work.—The present status of bank credit work may be judged from figures made available as the result of a survey of 20 representative banks in the city of New York. Out of a total of 16,395 persons employed by these banks, 1,398 were officers and department heads, and the remaining 14,997 were engaged in clerical work. Of the latter, not less than 1,118, or approximately 8 per cent, of those actively engaged in clerical work were directly or indirectly connected with the credit departments. Among them are included 241 credit investigators.[1] It should be observed at this point that credit work of the specialized type is still in its infancy and that numerous banking institutions throughout the country are either organizing special and separate credit de-

[1] PRUDDEN, R. F., "The Bank Credit Investigator," chap. 1, pp. 11–13.

partments or are in the process of increasing the personnel of the already existing credit departments, or both.

Banks and Commercial Houses Compared.—In credit granting, the difference between banking institutions and commercial houses lies in the standards set for such purposes. As a rule, banks are far more conservative in the extension of credit, chiefly because of the comparatively small margin of profit on which they operate. Besides, a bank must always be in a position to meet its obligations at maturity. Acting in the capacity of custodian for the funds of depositors, the latter require a high degree of certainty and confidence in the bank's ability to meet its obligations at all times, and particularly at maturity. Unlike a mercantile house, a bank cannot ask for extensions of its obligations without jeopardizing its reputation and good will. In mercantile as well as in personal credit, when debtors are unable to pay their bills or notes when due they request an extension of time, which is frequently granted, voluntarily or involuntarily. For a bank to be unable to meet its obligations at maturity may mean a cessation of its business activity and consequent failure. For these reasons, a bank credit department is forced to investigate its risks more thoroughly, scrutinize the information with greater care, and base its loans, wherever possible, on collateral capable of quick realization. It is also advisable that loans be diversified in regard to lines of business, locations, and maturities. Furthermore, businesses dealing in staples selling on short-credit terms should, other things remaining the same, be given preference over luxuries or lines which sell on long-credit terms. Finally, well-established concerns, the management of which is known to be conservative, should be sought in preference to new and unseasoned organizations.

Basis for Loans and Discounts.—Profits of a banking institution are made on loans extended to individuals and firms. Loans are generally made in the form of credit, for when one secures a loan from a bank, this loan usually appears as a deposit and the borrower merely obtains the privilege of drawing checks up to a certain amount in return for his promise to repay an equivalent at a specified date in the future, or on demand, as in case of "call" loans. Similarly, when one discounts another's note at the bank, one simply *exchanges* the maker's credit, plus one's own as indorser, for that of the bank. Even when money

is paid immediately to borrowing or discounting customers, this money takes the form of its own or other banks' notes which are payable on demand and considered as satisfactory a means of payment as gold.

As a basis for loans, a bank may use its own funds, secured from the sale of stock over and above the amount required for buildings, fixtures, and supplies. These funds, however, constitute a very small, and in some instance an almost negligible, percentage of the total amount loaned. Hence, the necessity for another basis or reserve behind loans. This basis consists of deposits made by individuals and firms who prefer to use bank credit instead of the funds thus deposited. Deposits originate in two ways, actual deposit of funds, and deposit of credit from loans. Since deposits of the latter kind are usually withdrawn within a short time, banks attempt to secure as many of the former kind as possible. The greater the amount of net deposits—the difference between total deposits and checks—the larger the sums that may be loaned, and, consequently, the greater the profit a bank will earn.

Loans and Discounts.—A discount is merely one form of interest, but differs from ordinary interest in that it is calculated as a certain per cent of the total amount that is repaid, and is deducted from the principal of the loan in advance. Ordinary interest is paid at the maturity of the loan or at stated intervals in case of long-time loans, and is computed as a per cent of the amount loaned. Thus, when a bank buys a note, draft, or acceptance, it purchases it at a discount, *i.e.*, the interest is deducted in advance, and calls the loan a "discount." If the interest on the note is to be received at a later date, the process is termed a "loan."

Kinds of Bank Loans.—A bank may loan on any one of a number of credit instruments, as already pointed out somewhat in the preceding chapter. These instruments may be secured or unsecured. A secured loan is one made by the bank on a note or draft secured by collateral, *i.e.*, property pledged in payment of the debt. Security offered may consist of real estate, bonds, stocks, warehouse receipts, pipe-line certificates, bills of lading, merchandise, notes receivable, or other property, both tangible and intangible. Thus, "commodity paper" is secured by a warehouse receipt attached to the note; "collateral notes," by a deposit of bonds and stocks, etc.; and "mortgage

notes," by mortgages on property. Collateral deposited in numerous cases consists of bonds and stocks. Securities listed on an important stock exchange are the most desirable for such purposes, due to the relative ease with which they are convertible into cash. A typical form of a collateral note is here submitted in order to denote clearly the nature and extent of security underlying a secured loan (see Fig. 11).

Unsecured loans consist of loans or discounts based upon the financial and credit responsibility of the maker or makers, acceptors, or indorsers. They involve no specific pledge of property as security. Examples illustrative of this type of bank loans are numerous. Persons or firms enjoying a good credit standing may borrow on their own notes; this gives rise to "single-name" paper; or they may indorse and sell notes payable to them. This latter process gives rise to "double-name" paper, sometimes termed by bankers, "two-name" paper, "indorsed" paper, or "receivables." When the indorser places his signature on a note merely for the purpose of accommodating the maker, the resulting "double-name" paper is known as "accommodation paper." Banks frequently guarantee the credit of individuals and thus make it immediately available by accepting their drafts payable at a future date, for a commission. In doing so, the value of the draft is enhanced and its sale facilitated considerably. Under such an arrangement the borrower obligates himself to supply the bank with the necessary funds in order to meet the acceptance at maturity, in which case the bank has merely loaned its good name or credit. It is only when the borrower fails to provide the necessary funds that the bank is forced to make an actual loan in the form of money or credit actually paid out to the holder of the acceptance.

Discounting Single-name Paper.—It should be noted at this point that the discount method merely involves an exchange of the bank's credit for the individual's or business firm's credit. The advantage from such an exchange is the general acceptability of the bank's credit as contrasted with the limited acceptability of the other. A purchaser of a bill of goods may immediately satisfy the seller in one of three ways. If he is a person of ready means in whose ability to meet obligations at maturity the bank has full confidence, his own note will be taken to the bank and discounted, whereupon he is immediately credited upon the bank's books for the amount of the note, less the discount. A

$_____ Columbus, Ohio, _____ 19____

_____ after date, FOR VALUE RECEIVED $\frac{\text{I}}{\text{WE}}$ jointly and severally promise to pay to the order of THE OHIO NATIONAL BANK OF COLUMBUS, at its place of business in Columbus, Ohio, _____ Dollars

in United States gold coin or its equivalent, with interest at the rate of eight per cent. per annum after maturity until paid. And the undersigned do hereby authorize and empower any Attorney-at-Law, in the State of Ohio, or elsewhere, in our names and behalf, or in the name and behalf of any or either of us, to appear before any Court of Record, in said State of Ohio, or elsewhere, at any time after this obligation becomes due, in an action thereon, and waive process and service thereof, and without notice, confess judgment against us, or any or either of us, in favor of the payee or the legal holder, endorsee, or assignee of the said note, against us or any or either of us, for the amount that may appear to be due thereon, for principal and interest, damages and costs of suit, including attorney fees, and to waive and release all errors in the judgment so confessed, and all petitions in error, and to waive and release all right and benefit of appeal, and any and all proceedings to set aside, vacate, open, suspend, stay or reverse such judgment, or any execution issued for the collection thereof. There has been deposited with the said payee as collateral security for the payment of this note, or any note given in extension or renewal thereof, or any part thereof, as well as for the payment of any other liability or liabilities of the undersigned to the said payee due or to become due, whether now existing or hereafter arising, the following property, viz:

_____

_____

_____

_____

of a market value estimated by the undersigned at $_____; and the undersigned agree to deliver to said payee additional securities to its satisfaction, should the market value of said securities suffer any decline, and also hereby give to the said payee a lien for the amount of all the said liabilities upon all the property or securities given unto or left in the possession of the said payee by the undersigned, and also upon any funds on deposit to the credit of the undersigned with the said payee. On the non-performance of this promise, or upon the non-payment of any of the liabilities above mentioned, or upon the failure of the undersigned, forthwith, with or without notice, to furnish satisfactory additional securities in case of decline, as aforesaid, or in case of insolvency, bankruptcy or failure in business of the undersigned, or either of them, or in case an application is made for or there is an appointment of a receiver, assignee, referee, trustee, creditors' committee, guardian, agent or attorney for the undersigned, or either of them, or in case the undersigned, or either of them, remove from the City of Columbus, Ohio, sell out their business, or their place of business is damaged or destroyed by fire, tornado or flood, or in case a judgment is obtained in Franklin County, Ohio, or elsewhere, against the undersigned, or either of them, or an attachment is levied against their property or a decree for alimony is rendered against either of them, or in case the City of Columbus is put under martial law, or in case the United States declare war against any nation, or war is declared against the United States by any nation, or in case of conviction of any of the undersigned for any crime or misdemeanor, then and in each and every such case, this note and all other liabilities of the undersigned or any of them, shall forthwith become due and payable, without demand or notice, and full power and authority are hereby given to said payee to sell, assign, and deliver the whole of the said securities, or any part thereof, or any substitutes therefor, or any additions thereto, or any other securities or property given unto or left in the possession of the said payee by the undersigned, for safe-keeping or otherwise, at any broker's board or at public or private sale, at the option of the said payee, or its assigns, without either demand, advertisement or notice of any kind, which are hereby expressly waived. At any such sales, the said payee may purchase the whole or any part of the property sold, free from any right of redemption on the part of the undersigned, which right is hereby waived and released. In case of sale for any cause, after deducting all costs or expenses of every kind for collection, including attorney fees, sale or delivery, the said payee may apply the residue of the proceeds of the sale or sales so made, to pay one or more of all the said liabilities to the said payee, as he shall deem proper, whether then due or not due, making proper rebate for interest on liabilities not then due, and returning the overplus, if any, to the undersigned, who agree to be and remain liable to the said payee for any deficiency arising upon such sale or sales. The undersigned do hereby authorize and empower the said payee, at his option at any time to appropriate and apply to the payment and extinguishment of any of the above-named obligations or liabilities, whether now existing or hereafter contracted, any and all moneys now or hereafter in the hands of the said payee, on deposit or otherwise, to the credit of or belonging to the undersigned, whether the said obligations or liabilities are then due or not due.

No._____

Due _____ _____

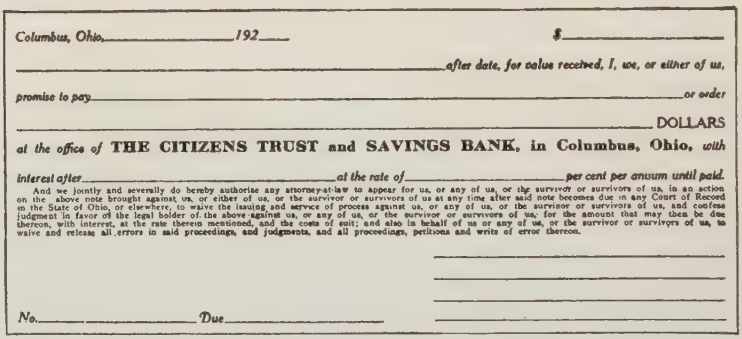
Discount $_____ _____

FIG. 11.—Promissory note secured by collateral.

discount is but interest paid in advance. Subsequently, a check is forwarded to the seller and the account is settled. Such a note constitutes single-name paper, since at maturity the maker is the only person to whom the payee may look for satisfaction.

Another way of satisfying the seller is for the buyer to offer his credit in exchange for the merchandise obtained. If accepted, the latter is debited or charged on the books of the former for the amount of the bill until the expiration of the credit period. Meanwhile, the seller in need of funds may have his own notes discounted at his bank, so as to enable him to finance the purchaser. In this case, the bank is extending a loan on the basis of single-name paper offered by the seller.

Double-name Paper.—A third method open to the buyer is to tender his promissory note in exchange for the goods purchased.



Columbus, Ohio, _____ *192*____ $_____

_____ *after date, for value received, I, we, or either of us,*

promise to pay _____ *or order*

_____ DOLLARS

at the office of **THE CITIZENS TRUST and SAVINGS BANK, in Columbus, Ohio,** *with*

interest after _____ *at the rate of* _____ *per cent per annum until paid.*

And we jointly and severally do hereby authorize any attorney-at-law to appear for us, or any of us, or the survivor or survivors of us, in an action on the above note brought against us, or either of us, or the survivor or survivors of us at any time after said note becomes due in any Court of Record in the State of Ohio, or elsewhere, to waive the issuing and service of process against us, or any of us, or the survivor or survivors of us, and confess judgment in favor of the legal holder of the above against us, or any of us, or the survivor or survivors of us, for the amount that may then be due thereon, with interest, at the rate thereon mentioned, and the costs of suit; and also in behalf of us or any of us, or the survivor or survivors of us, to waive and release all errors in said proceedings, and judgments, and all proceedings, petitions and writs of error thereon.

_____

_____

_____

No. _____ *Due* _____ _____

FIG. 12.—Unsecured promissory note.

This gives rise to notes receivable, which, when indorsed by the seller, are discounted at the bank. In this instance the seller or indorser remains secondarily liable on the note, so that, when the maker defaults in payments, the bank will look to the indorser. Notes receivable are the commonest form of double-name paper and the discounting of such instruments constitutes the simplest form of bank loans.

Accommodation Paper.—Accommodation paper is another form of double-name paper. It is a note bearing an accommodation indorsement and hence not regarded with favor by banks. Frequently, would-be borrowers exchange their notes, take them to their respective banks, and have them discounted as double-name paper. Both of these borrowers are likely to be weak financially and neither of them could therefore borrow

on his name alone. In reality, the indorsement of one weak concern's paper by another weak concern does not improve the character of the note. It does give the note, however, a semblance of strength which it does not inherently possess. Again, an individual with a good credit standing might be urged by a friend to accommodate him by indorsing the latter's note, thereby lending it an appearance of strength which it would not otherwise possess. In case of default in payment by the maker, it becomes difficult to collect from the accommodation party.

From the foregoing it is obvious that accommodation paper is inferior as contrasted with notes arising out of the sale of goods, and should be accepted by banks only with great hesitancy.

Figure 12 is a typical form of an unsecured promissory note.

LOANS THROUGH NOTE BROKERAGE HOUSES

Rise of Brokerage Houses.—Note brokerage business is of relatively recent origin. Before 1870 single-name paper was little known. Banks seldom made loans on one signature or even one indorsement. Then, too, very few open book accounts are to be found prior to this date. Buyers ordinarily gave notes which were indorsed by sellers and discounted at the bank. The widespread use of double-name paper led to the abuse of the system through flooding the market with accommodation notes which are difficult to distinguish from *bona fide* double-name notes arising out of commercial transactions. As a result, banks suffered considerable loss and the demand for renewals grew by leaps and bounds. Consequently, banking institutions commenced to scrutinize such paper more carefully. This fact, coupled with the growing competition among sellers, served to stimulate the use of open book accounts.

Because of the risk involved in carrying customers on the books for extremely long periods—the credit period formerly averaging from four to six months—liberal discounts were offered for cash payment. To take advantage of the opportunity of making extra profit through discounts, the stronger merchants borrowed at the banks on their own single-name paper. As the local banks were often limited in their financial resources, merchants began to sell their notes through brokers to outside banks.

This practice grew so rapidly that R. F. Prudden, in his book, "The Bank Credit Investigator," claims that there are at present over 25 representative note brokerage houses in this country, some of which established many branches and connections.

Methods of Operation.—Brokers usually operate on a commission basis, the size of the commission normally amounting to one-quarter of 1 per cent flat. Most brokers immediately advance a certain percentage, say 80 per cent, against the paper, and remit the remainder after deducting the commission when the paper is finally disposed of. Some few brokers even discount the whole block of paper outright at the current rate of discount and then sell it to banks or other investors.

It should be observed that no definite method or formula is adhered to by any one brokerage house. The methods of operation may vary according to the business house giving the notes for sale and the stage of the business cycle, whether money is "hard" or "easy," and numerous other similar considerations.

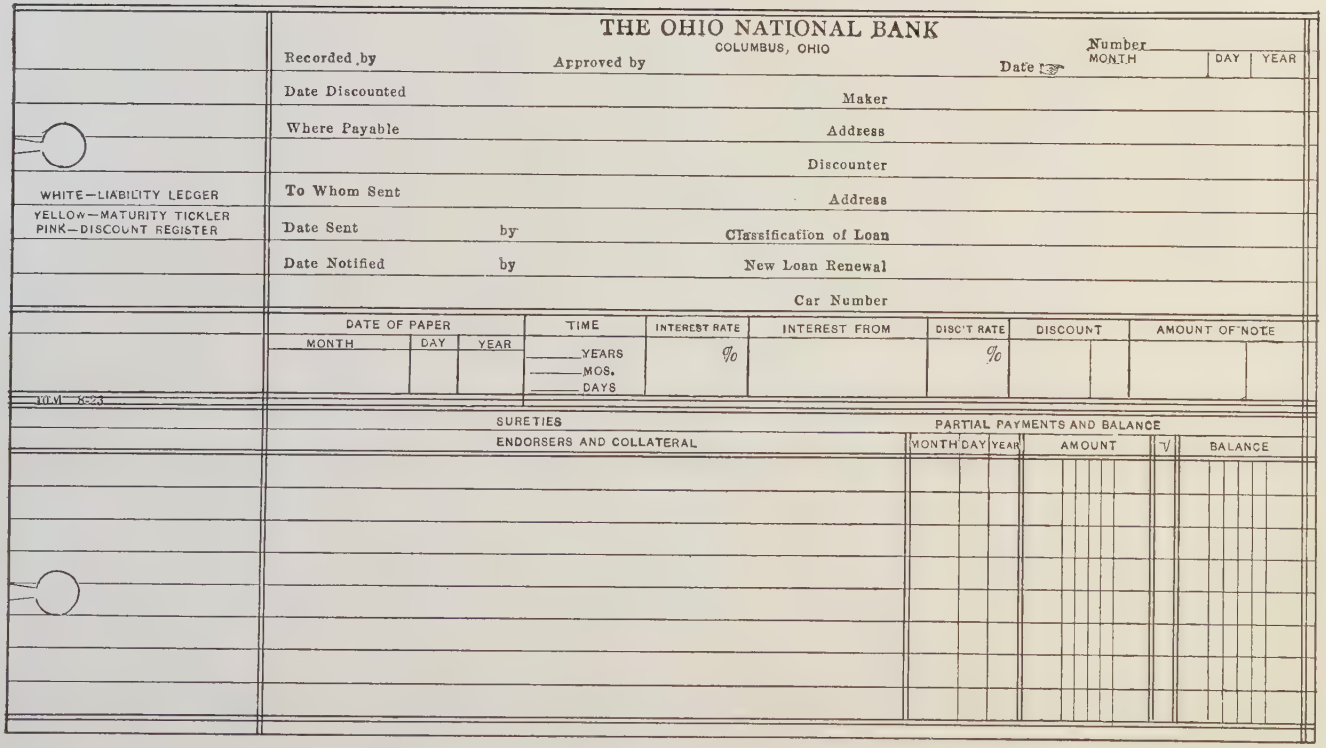
Advantages of Selling in the Open Market.—The advantages of selling through brokers are many and varied. To begin with, the borrower secures by this means a wider market for his paper, frequently at rates of interest considerably lower than those prevailing in the locality in which he is situated. Again, borrowings from his local bank are limited to 10 per cent of the bank's capital stock and surplus. Difficulties may be experienced as a result, particularly during peak seasons. Through the broker, additional banking connections are secured. Furthermore, local banks require the borrower to maintain approximately 20 per cent of the loans in cash at all times. Then, too, when borrowing in the open market through note brokers, the borrower's name becomes known to many banks and his credit standing may improve substantially when the obligations are promptly discharged and few renewals are demanded.

Advantages of Buying Paper in the Open Market.—From the standpoint of the banker, note brokers equally offer many advantages. Paper purchased in the open market is usually regarded by banks as a particularly attractive investment. In the first place, this kind of commercial paper is highly marketable and readily convertible into cash. Maturity dates can be chosen so as to provide for liquid capital to meet current needs. Higher rates than those prevailing in the section tributary to the purchasing bank are often obtainable. Commercial paper can

be readily rediscounted by the purchasing bank at the Federal Reserve Bank of which it is a member. A minor advantage is that these notes can be had in practically all denominations, making diversity of investment possible. Moreover, few of these notes are renewed. There is no obligation on part of the banker to renew them even when requested to do so, due to lack of personal influence. Last, but not least, the security is of a premier character. Although legally note brokers are merely guaranteeing the genuineness of the signature, yet in practice their responsibility is greater than is apparent. Brokers frequently have their own funds invested to a certain extent in the paper they handle, but, most important of all, they have a reputation at stake, which constitutes a substantial part of their stock in trade. In addition, brokers give banks, as a rule, a ten-day option within which to investigate the credit standing of the borrower, and if results of the investigation do not warrant the purchase, the notes can be returned, without any further obligation to the bank.

Disadvantages of Selling Notes in the Open Market.—Some houses are known to object to selling commercial paper in the open market through brokers. The principal reason for the unfavorable attitude is the constant inquiry to which a borrower using this method is subjected. He is asked for a great mass of more or less detailed information over and over again. This in itself has two objectionable features: first, it may arouse suspicion among the borrower's commercial creditors; and, second, it necessitates a complete removal of secrecy which many houses regard as essential to success.

Recording Commercial Paper Purchases.—Some banks record all purchases of commercial paper on special forms in which all of the necessary information is given in one or two lines. The several columns of these forms give the date and amount of the purchase, due date, rate, from whom bought, and remarks. Probably in the majority of banks, however, a form similar to the one presented herewith (see Fig. 13) is used for the purpose. Enough spaces are provided in this form so that all sorts of transactions may be recorded therein. These forms are generally made out in triplicate, the white sheet being placed in the liability ledger where all names are arranged alphabetically, the yellow sheet in the maturity tickler, in which all accounts are arranged according to date of maturity; the pink



THE OHIO NATIONAL BANK
COLUMBUS, OHIO

Recorded by | Approved by | Date ☞ | Number | MONTH | DAY | YEAR

Date Discounted | Maker

Where Payable | Address

Discounter

To Whom Sent | Address

Date Sent | by | Classification of Loan

Date Notified | by | New Loan Renewal

Car Number

WHITE—LIABILITY LEDGER
YELLOW—MATURITY TICKLER
PINK—DISCOUNT REGISTER

DATE OF PAPER			TIME	INTEREST RATE	INTEREST FROM	DISC'T RATE	DISCOUNT	AMOUNT OF NOTE
MONTH	DAY	YEAR	____YEARS ____MOS. ____DAYS	%		%		

SURETIES ENDORSERS AND COLLATERAL	PARTIAL PAYMENTS AND BALANCE MONTH	DAY	YEAR	AMOUNT	√	BALANCE

FIG. 13.—Form commonly used to record the purchase of paper.

or triplicate sheet is given a number and placed, according to a numerical arrangement, in the discount register. A form is made out for each note purchased or discounted.

Another form commonly used by banks is a control sheet, one for direct liability of the account and one for indirect liability. These sheets are placed in front of the various individual note records of the respective accounts. Each control sheet contains

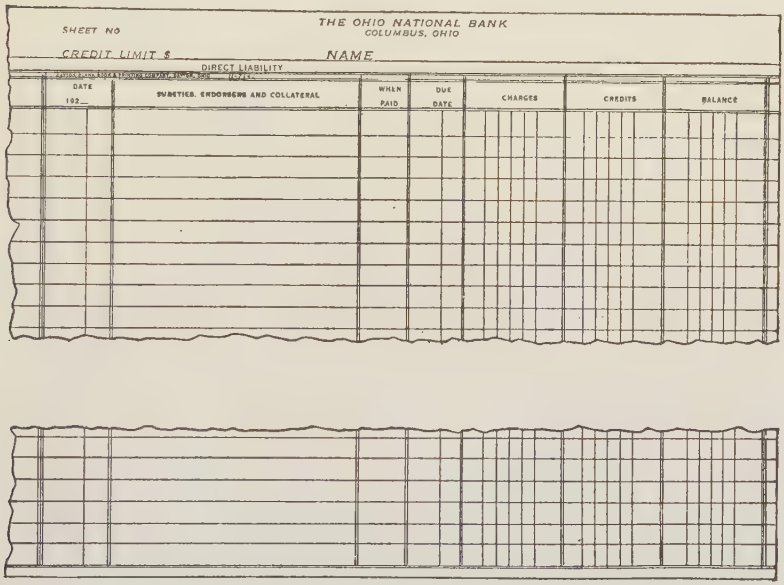


FIG. 14.—Control sheet (yellow) showing direct liability of a given account. Similar blue sheet shows all indirect or contingent liability of each account.

a summary of all the notes held by the bank against any one account, showing the date of purchase; sureties, indorsers and collateral; when paid; due date; charges; credits; and balance (see Fig. 14).

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WALL, A.: "The Bankers' Credit Manual."

CHAPTER IV

RETAIL CREDITS

Definition and Significance.—Retail or personal credit is the credit a merchant extends to an individual or his family when goods are purchased for consumption purposes. Although the retailer is the merchant primarily and directly interested in this type of credit, yet jobbers, functional middlemen, and manufacturers are indirectly, though not less vitally, concerned with it. The success in credit granting along the entire chain of distribution depends ultimately upon the payments by consumers to retailers. Prompt payment of one's obligations to the retailer enables the latter to cancel his obligations incurred in the purchase of these goods from the wholesaler or jobber. The wholesaler, in turn, is in a position as a result to meet his obligations incurred in the purchase of merchandise from functional middlemen or manufacturers. As a corollary of this it naturally follows that, should the ultimate consumer fail to meet his obligations, the consequent weakness of the retailer will invariably be reflected all along the various links in the chain of distribution. When such a situation becomes accentuated, the whole credit system is threatened.

It is obvious from the foregoing that the larger part of the credit system is built around personal or retail credit. The jobber grants credit to the retailer in order to enable the latter to meet the demands of the consuming public. In his turn, the jobber demands credit extensions from his sources of supply. Finally, manufacturers must either possess adequate financial resources of their own, or else resort to the aid of functional middlemen, such as brokers, commission houses, or factors. In addition, all of them enlist the aid of the financial specialist—the commercial banker

ARGUMENTS FOR RETAIL CREDITS

It is frequently argued that, from the standpoint of society at large, it is doubtful whether retail credit is necessary. Even

some retail merchants themselves occasionally doubt the feasibility of such a policy. Excellent evidence of an unfavorable attitude toward retail credit granting is afforded by the enormous growth of stores since 1910 based on a "cash and carry system." Some of the strongest arguments, nevertheless, are favoring the adoption and use of credit policies. These arguments may be arranged in two groups according to the parties interested.

From the standpoint of the merchant it is argued that:

1. Credit Ties Up Trade.—It makes regular customers. Patrons with charge accounts usually give their entire trade in a given line to a limited number of stores. A credit customer, as a rule, trades regularly in the store with which credit connections have been established. At least, the first choice is given the institution in which a charge account is had. Thus, credit makes for repeat business.

2. Credit Sales Are Larger on the Average.—Cash customers are constantly on the lookout for startling bargains. They are attracted to a larger extent by advertising, are interested in a larger measure in price, and generally shop around more. This group constitutes the class of habitual bargain hunters, who, on the average, muss up larger quantities of merchandise, flit from store to store, and buy less per person.

3. Credit Customers Buy More.—On the average, it is believed, customers having charge accounts buy more freely and are somewhat more extravagant. They do not for the most part realize the value of money, because of postponement in payment, to the same extent to which cash buyers do.

4. Credit Develops Confidence.—By trusting goods to a customer, the store, in turn, gains the confidence of the buyer. Confidence breeds good will, without which no merchant can claim success. A credit system also insures permanency of the store in the community. A merchant of a dishonest character will not trade on a credit basis. On the other hand, the straightforward retailer, by dealing squarely with his trade, does not fear that his customers will refuse payment for value received.

5. Credit Attracts Better Trade.—Contrasted with cash stores, businesses selling on credit appeal to a better type of trade which is interested primarily in service, quality, and style, and is only incidentally concerned with price. Cash stores usually attract the poorest and cheapest trade and become

known as cheap stores. Most of the urban department stores operating purely on a cash basis are of this type.

6. Credit Irons Out Business Peaks.—It makes for a better distribution of business volume. Cash trade tends to peak on certain days, such as Saturdays and pre-holiday periods, when wages or salaries are obtained and cash is readily available. Credit customers, on the contrary, buy whenever goods are needed, irrespective of their possession or lack of money at the time. Peaks are costly. Because of them, larger inventories must be carried regularly and the selling problem becomes more complex. Excessive clerical help must be normally carried on the pay roll and many "extras" be kept in touch with. In support of this argument, it may be stated that, according to investigations conducted by the author, department stores selling on both cash and credit report that on Saturdays the increase in volume of business comes primarily from cash purchasers and that no noticeable variation is observed in the sales to credit accounts on such days. Credit thus tends to prevent concentration of sales and irons out the peaks in business.

7. Credit Reduces Complaints.—Failure to deliver purchases promptly does not tend to arouse any suspicion on part of credit customers, whereas purchasers who have paid in advance are likely to get disgruntled and panicky under such circumstances and complaints are immediately registered to that effect. The assumption on which this argument is based is that consumers lack confidence in a store which insists upon payment for the goods in advance, since only dishonest merchants refuse to grant credit. It is obvious that this line of reasoning is not entirely sound. Credit may be denied because of a number of reasons. The particular credit risk may be inferior, or the store may operate on a purely cash basis for economic reasons, as will be indicated in the following pages.

8. Credit Sales Are More Economical Than C.O.D. Sales.—To begin with, when sales are on a C.O.D. basis, a special system of handling them must be provided in the delivery department. They must be segregated from the others and properly accounted for. Additional clerical help is necessitated and often a separate C.O.D. room is maintained. Moreover, when the customer is not at home at time of delivery the merchandise must be taken back and "sent over" again, thereby bringing about duplication of effort. If the customer is at home,

additional time is consumed in making collections, especially when she insists on examining the goods prior to making payment.

9. Credit Is a Customary Convenience.—People are accustomed to receiving credit and, to be successful, a merchant must meet the demands of his trade. Purchases are frequently made by different members of the family, while payment is made by the one who has control of the financial end. Credit makes such practice possible. Again, some persons are paid at definite intervals—wage earners and many clerks receive compensation weekly, while the salaried group ordinarily receives payment on a monthly basis. These individuals are compelled to wait for their earnings and they justly feel that retailers of whom they buy should do likewise. Moreover, many wage earners live from hand to mouth, especially during periods of stress and unemployment, and, consequently, possess no ready cash with which to pay for purchases until pay day when wages are received. Similarly, in farming communities, consumers are frequently compelled to wait for cash until the crops are harvested and marketed. When prices are depressed and unsatisfactory, the period of waiting may be considerably prolonged until resumption in buying on a large scale commences.

Then, too, customers who are able to pay cash are unwilling to do so because of the inconvenience incident to carrying around money at all times to pay for purchases, especially when small and frequent. Credit also makes it possible to place orders by telephone and to depend upon the merchant to make delivery and leave the goods even in the absence of the purchaser. This, of course, applies only to stores which also render telephone and delivery services. Finally, home accounting is simplified and facilitated by the credit system. Periodic payments are easily kept track of and the housewife can manage the home on a budget plan. To be sure, when cash stores render a receipt each time a purchase is made the same object could be accomplished, though with slightly greater difficulty. However, as yet few cash stores are following the practice of rendering such receipts.

When viewed from the standpoint of social welfare, it is claimed that:

1. Credit Improves Quality of Merchants.—Credit rests essentially on confidence. Confidence in customers arises out of an intimate knowledge of the trade. A knowledge of his

clientele facilitates the rendering of merchandise and services on the part of the merchant in accordance with the requirements of the community. Buying can be done more scientifically and merchandise plans accurately drawn up. It should also be remembered that credit customers regularly and steadily patronize the store in which they have a charge account. Their needs can, therefore, be more readily anticipated and future requirements more easily forecast.

2. **Credit Improves Quality of Selling Service.**—A knowledge of the idiosyncrasies of the different customers on the part of the salespeople makes it easier for them to serve the trade and sell satisfaction and good will. Charge customers are regular customers and clerks learn to know them and serve them accordingly. At least, some cash stores are cold and impersonal. It must be admitted, however, that poor clerical service is not inherent in a cash policy, although it almost invariably accompanies it, primarily because cash stores generally make a price appeal which is possible only through various kinds of savings in buying as well as in the selling aspect of merchandising.

3. **Credit Economizes Customer's Time.**—It is claimed that less time is involved in charging a sale than in receiving payment and making the necessary change. This is particularly true where authorization is quick and effective. The significance of the argument also depends upon whether the cash store has a centralized or decentralized cashiering system.

ARGUMENTS AGAINST RETAIL CREDITS

1. **Credit Increases the Cost of Doing Business.**—Even credit stores will admit that it is impossible to operate on a credit basis without some loss. The loss from bad debts is inevitable and may be caused by human or external factors beyond man's control. The debtor may be dishonest and unwilling to pay, or external events may occur, such as a failure of crops, accidents, general business depression, the effect of which is to reduce his ability to meet his obligations. To the extent of such loss, the retailer is called upon to support some people with necessities and sometimes luxuries. He, in turn, seeks reimbursement from the public wherever permitted by competitive conditions. This is accomplished by adding the amount of loss to the selling price of the goods. In addition, the expense incurred in maintaining a credit department and an adequate personnel to care for both

credit granting and collections must necessarily be added to the normal cost of operation.

Credit stores, however, claim that the expense incident to credit granting is not unlike that incurred in advertising. An expense is not an expense in the true sense when the gross profit attributed to it exceeds the amount expended for the purpose. Although the losses in retail establishments incident to bad debts and failing accounts amount to from 1 to 2 per cent of all credit sales, on the average, the consequent increase in volume of business and corresponding net profit more than offset the amount of loss.

2. **Cash Customers Pay for Bad Debts.**—It is frequently argued that cash customers as well as those who pay their bills promptly are penalized and that they are caused to pay for credit losses. These classes of customers are charged the same prices as poor-pay customers and, since the prices in a store operating on both a cash and credit basis are necessarily high on account of losses from bad debts, the former are penalized and unduly taxed.

On the other hand, cash customers shop around considerably, buy less and in smaller quantities, and in many other ways raise the cost of operation, while credit trade rolls up volume—so essential to economical operation of a retail institution.

3. **Credit Leads to Extravagance and Recklessness.**—Charge accounts induce people to buy more and live beyond their means, arguments to the contrary notwithstanding. Nevertheless, extravagance could be curtailed by proper education regarding the use of a credit system. Besides, cases abound of wage earners who spend all of their weekly income at one time, extravagantly and carelessly, and go without necessities until the following pay day. Thus, extravagance is not practiced solely by persons purchasing on charge accounts.

4. **Credit Ties Up Capital.**—Charge accounts require a larger capital investment. A merchant who wishes to engage in credit granting must possess more capital to secure a given volume of business than a merchant who operates on a cash basis only. Capital turnovers are decreased accordingly, but the additional funds are well invested. More trade is secured, and economies from large-scale operation are gained which more than offset the interest cost of the additional investment.

5. **Credit System Invites Complaints.**—So many credit customers feel their preferred position and take advantage of it.

Many complaints are registered as a result, and adjustments are asked for. Some of them even act occasionally as if they owned the store. In justification of this position, credit stores claim that credit customers, because of their concentration of purchases and savings effected thereby, are entitled to more attention and greater consideration. Besides, most of the complaints are not unreasonable and an up-to-date merchant aiming at a maximum of service should welcome them, irrespective of their origin.

FACTORS DETERMINING CASH OR CREDIT POLICY

Class of Trade.—In considering the question of a cash versus credit policy, a retail merchant must not confine himself entirely to an analysis of the advantages and disadvantages of the two alternatives. A number of additional factors must be carefully scrutinized and appraised. It is a matter of common knowledge that a retail storekeeper has the choice of emphasizing one or more of three types of appeal to the consuming public. He may emphasize price, quality, or style, in addition, of course, to stressing the reputation and superior service of the store. In choosing the price appeal, a merchant automatically eliminates that class of trade which is only secondarily interested in price, namely, those strata of society falling within the medium and higher ranges of income. Obviously, a store emphasizing price attracts the trade of the lower social stratum, as judged by the size of income, and, in addition, gains the trade of the habitual bargain-hunters.

When the emphasis is shifted from price to quality or style, the appeal is automatically directed to a class of trade primarily concerned with the appearance or quality of the goods, and only incidentally interested in price. These customers require services of which credit extension is a significant form, and are willing to pay for them, provided the additional cost is not unreasonable. Under these circumstances, it is highly advisable that a merchant meet the demand of the trade in order to insure his own success.

Line of Goods.—Another factor in determining credit policy is the line of merchandise handled. Goods within lower ranges of price lend themselves more readily to a cash system. It is customary to pay cash for relatively small purchases. This fact may partially account for the phenomenal success of chain stores dealing in lines of merchandise falling within the lower

price ranges. Ready cash to pay for large purchases is frequently not available and it is customary to have such purchases charged. Groceries and drugs are examples of the former, while furniture, clothing, automobiles, washing machines, and the like characterize the latter type of merchandise ordinarily purchased on time.

Competitive Conditions.—A third factor consists in the nature and keenness of competition. To the extent to which consumption goods become standardized and nationally advertised by manufacturers is the nature of price competition on the part of retailers diminished in importance, save when articles are used as loss leaders in featuring bargain sales. The tendency then is for retail dealers to shift the basis of competition from price to service or quality, as in the case of private brands. Credit granting is one of the most important forms of service. Hence, retailers resort to it as a means of meeting competition. The keener the competition in a given community the more likely are the stores to feature the credit service as an attraction.

Sectional Preferences.—Then, too, sectional preferences and the character of community incomes must not be overlooked. It is commonly known that in the South credit is more freely sought than in other portions of the country. The same applies to mining and farming communities, where ready cash is scarce between pay days and crops, respectively. In establishing a retail institution, local preferences should be duly considered, thereby avoiding the danger of adopting a policy necessitating a practice of running against the current.

Size of Community.—Again, the size of town in which the store is located must be given adequate consideration. In a large city there is always room for a limited number of cash stores. In these communities are to be found all classes of people with varying desires, ambitions, and incomes. Since cash stores primarily appeal to the trade of persons with limited incomes and bargain-hunting instincts, large cities should be sought, for in them reside sufficient numbers of such people to support a few of these stores properly. In smaller communities cash policies should be adopted only after great hesitancy.

Capital Commanded.—The capital commanded by the store is the last and a most significant factor in the determination of a cash or credit policy. Concerns with limited financial resources should either be satisfied with a limited volume of

sales or else operate on a cash basis, for, to roll up a certain volume of business, more capital is required when trading on a credit basis. In addition to merchandise inventories, customers must be carried on the books, thereby tying up more capital in the enterprise.

CARELESSNESS IN RETAIL CREDIT GRANTING

There is doubtless more carelessness in retail credit granting than in any other class of credit granting. Especially is this statement true of the large number of unit stores of the neighborhood type. This condition of affairs is due to the following factors:

1. The increased keenness of competition causes many retailers to strive to outdo their competitors in volume of business, usually at the expense of quality. To roll up the desired volume, many customers must be attracted to whom credit is extended rather liberally. Outwardly, the business shows evidence of prosperity. Inherently, it is based upon a false foundation, whereby standards of credit are debased and the whole credit system demoralized.

2. Undoubtedly, the most important cause of the neglect to live up to established and well-recognized sound standards of credit is the failure to keep posted on the exact condition of the business because of a lack of proper books of account. Without them, the merchant is ignorant of actual conditions; he does not know the cost of doing business, the amount of credit losses, collection expense, and the extent to which these cut into the net profit, if any is available.

3. Many retailers usually trust most customers at least once. Such a buyer may ask for credit "until next week," or "until he has sold his crop," etc. In all of these instances the date of payment is indefinite. In other instances the fault lies with the retailer, who fails to set a definite date for settling accounts and to insist upon prompt collections. At first, partial payments may enter into the account and, finally, the total amount lapses into slowness and collections are made difficult.

4. Some merchants are timid in making the investigations necessary to determine the character of the credit risk for fear that customers may resent such inquiries, resulting in a diversion of trade to stores of competitors. The fear of driving away trade thus prevents them from establishing retail credit on a

sound basis. It is true that many customers feel humiliated when what they regard as "strictly personal" matters are encroached upon.

5. Many merchants lack adequate facilities for obtaining credit information. Few retailers cooperate to the extent of exchanging information concerning applicants for credit. Manufacturers, jobbers, and bankers have numerous sources from which accurate and reliable information concerning the credit standing of customers may be secured. Not so with retail merchants. Few facilities have as yet developed whereby the credit standing of individuals in the capacity of consumers may be obtained, although great progress is to be noted in the multiplication and development of retail credit interchange bureaus, as will be indicated in a later and more complete discussion of this phase of credit work. Moreover, relatively few of the retailers as yet claim membership in these bureaus, partly because of negligence and lack of appreciation of their value on the part of retail merchants, and partly because of the cost involved in procuring a membership. The larger retail organizations, including department stores and the better class of unit stores in the shopping districts, generally take advantage of these services and, consequently, their credit granting is more scientific and, on the whole, much more satisfactory.

Effect of Careless Retail Credit Granting.—To begin with, the retailer himself is directly and most unfavorably affected by a failure on the part of customers to meet their obligations. To him credit is often a cause of recklessness and liquidation. If many retail dealers fail because of realization in their false hope of getting pay in the future, the jobber is equally affected, partly through losses from bad debts incurred in selling the retail trade on time, and partly through a decrease in sales. Purchases from the jobber are sometimes decreased because of the higher prices charged by retailers in an attempt to cover the losses incident to extravagant credit granting. The honest consumer who pays his bills promptly, as well as cash customers, is thus penalized. As prices rise, other things being equal, sales necessarily decrease, though not proportionally. The effect of unwise and improper credit granting by retailers thus extends even beyond the wholesaler and, indirectly, affects the manufacturer, broker, commission house, and banker.

Remedies Suggested.—To be successful in a credit business, a merchant must make a careful study of local business and economic conditions, carefully select his risks, secure and thoroughly examine an adequate quantity of credit information, constantly watch the progress of accounts, and insist upon prompt payment. To make his business more efficient, a retailer should keep adequate records giving information as to operating expenses, losses from doubtful accounts, and the like. An accurate knowledge of facts would prevent many a merchant from unconsciously plunging into questionable selling campaigns and extending credit unwisely. The establishment of a customary method of procedure in making inquiries of customers would help overcome the general resentment on the part of credit seekers, and the information would come as a matter of course. Both consumer and retailer need to be educated to the standards upon which sound credit should be based. Finally, cooperation between retail credit grantors should be fostered. They should be made to realize that only through cooperative effort will the maximum efficiency in the management and operation of a credit business be attained.

INSTALMENT SALES

A constantly increasing number and variety of commodities are sold by retailers and manufacturers to the consumer on the instalment or part-payment plan. Clothing, sets of books, pictures, jewelry, furniture, electrical appliances, such as radios and washing machines, automobiles, farm tractors, typewriters, and the like, are sold on this basis on numerous occasions and the plan bids fair to become very general in many lines of trade. This plan calls for a partial cash payment when the article is purchased, the remainder being payable in instalments at intervals of one week or one month thereafter. A definite charge in the form of interest on the unpaid instalments may be added to the regular price, or the extra cost incident to the operation of such plan may be reflected in higher prices.

When the purchase involves a substantial sum, it is customary to require some sort of security from the customer. Frequently, the security obtained consists in a promissory note secured by a chattel mortgage on the property thus purchased. Sometimes additional property may be covered by the chattel mortgage. Should the maker of such promissory note fail to pay any of the

instalments when due, the remaining unpaid instalments generally become due and payable at the option of the holder of the note, and the property conveyed by the chattel mortgage securing the note may thus immediately be recovered by the holder thereof (see Fig. 15).

Advantages.—Like all forms of credit which tend to facilitate the transfer of goods, the instalment method has its advantages and disadvantages. The volume of sales is considerably increased by the plan, and many consumers with limited means are given an opportunity to enjoy more things in life than would have been possible otherwise. Were it not for this plan of making buying easier, comparatively few high-priced articles like those enumerated above would be sold to persons of small or moderate means. To compel these persons to pay the entire amount in cash at one time would practically eliminate them as prospective buyers of such commodities. "Pay as you ride" in the selling of automobiles, and "pay while you play" in the selling of pianos, talking machines, and other musical instruments are, therefore, appeals not without merit.

Objections to the Instalment Method of Sale.—On the other hand, the very ease with which numerous expensive articles can be secured when purchasing on the instalment plan leads to extravagance and living beyond one's means—a common evil of modern times. Only a dollar per week or per month is a bait which has brought in many purchasers whose income is totally inadequate and uncertain to warrant such luxuries. Furthermore, the prices paid for articles bought on the part-payment plan are frequently out of proportion to their real "cash" value. Instalment sales are as a rule costly. Losses due to bad debts, except when superior security is obtained in the form of chattels, are high, and the expense incident to collecting the instalments periodically and dealing with stubborn accounts is not a negligible item in the cost of operation. Customers may become delinquent several times in the course of their numerous payments. Hence, an elaborate collection system must be devised which will take care of the overlapping of the collecting of successive past-due payments. It also commonly happens that when the burden of meeting the constantly recurring obligations becomes tiresome, the customer desires to return the article, even though it necessitates a loss of his equity in it. Because the real profit to the seller lies in the last few payments,

$.....

COLUMBUS, OHIO,....., 19.....

FOR VALUE RECEIVED, I, we, or either of us promise to pay to the order of

.....

the sum of.....DOLLARS ($.....),

payable in.....monthly installments of.....DOLLARS ($.....)

each, the first installment being payable on the.....day of....., 19....., and the remaining installments at intervals of one month thereafter, with interest on the unpaid installments at the rate of 8% per annum from maturity. Payable at the office of The Republic Finance and Mortgage Company, 501 and 502 Schultz Building.

This note is secured by a chattel mortgage executed by the makers in favor of the payee. If the maker hereof shall fail to pay any installments of this note when or after the same matures, then the remaining unpaid installments of the said note, together with any accrued interest, shall, at the option of the legal holder hereof, become due and payable, without demand or notice, both of which are hereby expressly waived.

We hereby authorize and empower any Attorney-at-Law in the State of Ohio, or elsewhere, at any time after this note or any installment thereof becomes due, with or without process, to appear for us, or either of us, in any Court of Record, in the State of Ohio, or elsewhere, and there confess judgment against us, or either of us, in favor of the legal holder of this note, for the said amount, or any balance due thereon, with interest and costs, and to release and waive all errors, the right to a new trial, the right to prosecute error or appeal, and the right to stay of execution. The makers and endorsers of this note severally waive demand, protest and notice of non-payment.

Address ..... Street .....

City .....State ....

FIG. 15.—Promissory note covering an instalment transaction and secured by a chattel mortgage.

it becomes necessary to resell the commodity by means of "re-selling talks" through personal collectors or through correspondence, thus involving extra effort. It is obvious that all of these additional expenditures incident to the special selling method must be borne by the instalment purchasers who meet their obligations promptly.

A New Instalment Method of Sale.—A unique development in the instalment business, which offers possibilities for expansion, is the issue of order checks on the store as well as other established stores in the community. This system is confined as yet to one company operating in six of New England's largest cities. Although established as early as 1897, the company apparently has made greatest progress since 1912. It conducts credit houses in which order checks for credit are issued on its own and other established stores with which special arrangements have been made to have them honored and accepted in lieu of cash and to charge the issuing company with the amount. The customer, in turn, is required to remit to the issuing concern stipulated sums at intervals agreed upon at the time the order check is issued. Despite the fact that this credit company conducts its own stores, in which relatively high-class merchandise is carried, no effort is made at any time to induce patrons of the order check system to shift their purchases from the store of their choice to its own establishments.[1]

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CHAPTER V

MERCANTILE CREDITS

Definition.—Mercantile credit is the credit one merchant extends to another when selling goods on time for resale. Theoretically, it is the power to obtain merchandise for resale purposes in return for a promise to pay at a specified time in the future. It includes the credit granted by different sellers of goods in the process of distribution from the time the goods are in the state of raw materials until they reach the hands of the retailer.

Function of Mercantile Credit.—The principal purpose of mercantile credit is to facilitate the transfer of goods from the producer to the ultimate consumer. It does not include credit given by the retailer when selling on time, or that extended by manufacturers and functional middlemen when selling directly to the consumer.

Mercantile and Retail Credit.—The fundamental difference between retail and mercantile credit is that the former comes into existence as a result of a sale of goods for consumption purposes, whereas the latter results from transactions involving transfers of goods for purposes of exchange. The scale on which transactions involving mercantile credit are conducted is also much more extensive than that on which retail credit transactions are carried on.

Attention must be directed at this point to the fact that much of our credit structure is built around retail or personal credit. The motives compelling the retailer to grant credit to his customers have already been given exhaustive treatment. In order to be able to operate on a credit basis, the retailer, in turn, requests credit from the wholesaler. Accordingly, the wholesaler must be given time within which to collect from his trade and pay the manufacturer out of the proceeds. Since many growers and original producers of raw materials are financially weak and seldom in a position to finance through credit extensions, manufacturers or wholesale middlemen, these concerns turn

to financial houses, such as selling agents, factors, commission houses, or supply houses, to supply them with necessary funds. What has just been described constitutes the "regular" or "usual" channel of distribution, to which numerous exceptions are to be found.

Viewed from another angle, mercantile credit makes the neighborhood store possible, by enabling its owner to overcome financial handicaps. Without this intimate financial aid, men with limited capital would be handicapped in entering business and many struggling merchants of ability would be unable to continue if credit arrangements were to cease and cash were demanded for all purchases. To the extent to which these stores are desirable, is mercantile credit beneficial. This class of credit also tends to stimulate competition by bringing into existence numerous small retailers. Keen competition, if not excessive, fosters improvements in management and operation and reduces prices to the consumer.

Tendencies in Mercantile Credit.—Prior to the Civil War, jobbers and manufacturers were visited by retailers approximately every six months to purchase goods. Transportation facilities were exceedingly poor and the journey consumed considerable time. Because of the great distances separating retailers on the one hand and jobbers and manufacturers on the other, and the many handicaps incident to inferior and inadequate transportation means, some of the smaller retailers were compelled even further to limit their trips to the sources of supply. Sometimes purchases were made only once a year. Due to these conditions, retail dealers had to anticipate the local demand a long time in advance, and purchase infrequently and in large quantities. As a result, much of the stock on the shelves was unsalable and obsolete, although changes in style were fewer than today. The retailer was financially unable to carry the large merchandise inventories necessitated by the conditions described, hence he turned to the jobber or manufacturer for credit. This was granted, usually in exchange for a promissory note payable, as a rule, in six or eight months from date of purchase.

The development of railway transportation, coupled with the introduction and extension of adequate and suitable means of communication, such as the telephone, the telegraph, and expeditious mail service, brought about a complete change in the

circumstances surrounding the mercantile credit system. Retailers also increased in number and thus competition became keener. Retail dealers now visit the market more frequently and buy in smaller quantities, but at close intervals. Orders are also taken at present by traveling salesmen representing sources of supply, who visit the trade periodically. In the absence of traveling representatives, orders may now be placed by mail more expeditiously. The radio is also likely to produce marked changes in buying in the days to come.

Because of the importance assumed by the style element and frequency of its changes, the practice of carrying small inventories of up-to-date and fresh, salable merchandise becomes a necessity. Consequently, credit periods are considerably shortened. An additional factor contributing to the shortening of credit terms is the development of banking facilities, so that a retailer may now borrow at his bank and pay his bills with the proceeds from the loan.

TERMS OF SALE

Terms of sale commonly comprise two distinct elements: the extension of credit, and the discount which is usually coupled with it.

The Credit Period.—The length of credit granted varies not only with different lines of business, but also with different houses in the same line, and not infrequently no rigid policy is adhered to within any given establishment handling a single line.

Rate of Stock Turnover.—In general, the credit period tends to conform roughly to the receipt of income, on the part of buyers, from the sale of their goods. The rate of turnover of the purchaser's stock of goods is the most fundamental and determining factor as to the time involved in mercantile credit. Around it all the other factors revolve. These may, however, at times so modify the credit period as to, at least immediately, almost completely obscure any relationship existing between credit extension and turnover. Thus we find 30 days to constitute the prevailing terms in the grocery trade. In the hardware and dry goods trades, where the rates of turnover are lower on the average, we find 60 and 70 days, respectively, generally given to the retailers. Again, from 60 to more than 120 days are

granted retailers in the jewelry business, where the turnover is still less frequent than in the aforementioned trades.

Location of Customers and Transportation Facilities.—The rate of turnover is, in turn, affected by such considerations as the geographical location of the customer and the transportation facilities available for shipment of goods to him and the time consumed in the process. The longer the goods are in transit the slower the rate of turnover, since larger quantity purchases are necessitated and more merchandise must be kept on hand, therefore, the longer the credit period that is required of sellers. With the improvement of transportation service and the growth of appreciation on the part of merchants of the economies resulting from rapid stock turns there is a possibility of shortening credit extensions to a considerable degree.

Length of Credit Received from Preceding Sellers.—In numerous instances the credit period, as well as the discount offered for cash payment, is determined in large measure by terms granted by the preceding seller. Jobbers' terms to retailers on both anthracite and bituminous coal, for example, are similar to those received by them from the coal mine operators. Terms on automobile accessories given by accessory jobbers, in general, parallel those obtained from the manufacturers. On electrical products, wholesalers generally give their customers the same cash discount as they receive from the manufacturer, but the credit period varies.

Competitive Conditions.—Competitive conditions are often responsible for deviations from the regular terms in any given trade. Under such circumstances it is not uncommon to find many customers taking advantage of the situation and running their accounts even beyond the extended net period. A case in point is afforded by many wholesalers of electrical supplies. Here the keen and growing competition has forced them to give many concessions to their customers. A similar situation obtains in the coal business. Sometimes even exclusive connections are established when the buyer is carried by the seller.

Character of Commodity.—Distinction in terms is frequently made on the basis of the character of the commodities involved in the transaction. Fresh meat is generally sold on "cash terms," requiring payment within seven days after delivery, whereas provisions, including hams, bacon, lard, and barreled beef and pork, are sold on 30 days net. Both of these classes of products

are sold by the same meat-packing houses, yet the terms are different. In the grocery trade the credit period is longer and the cash discount larger on tea than on coffee, the time on the former ranging from 60 days to 4 months and the discount from 2 to 5 per cent, whereas the time on the latter ranges from 30 to 60 days and the discount from 1 to 2 per cent. Where little competition is experienced from exclusive tea and coffee houses, the tendency is for wholesalers to reduce the terms on both teas and coffees to 1/10, net 30 days.

The Credit Risk.—The character of the credit risk must also be considered in accounting for the length of the credit period in any transaction. When the risk is doubtful or inferior, the terms are very short. In many cases they may be sold on C.O.D. or "cash" terms, or cash may be required with the order.

Type of Ultimate Consumer.—Lastly, the type of ultimate consumer is a contributing factor in the determination of the length of credit extensions. In certain mining regions where the ultimate consumer—the miner—demands retail or personal credit and where sales fluctuate violently at times, due to local conditions of employment, the terms granted by jobbers are longer normally—save to bad risks—than in communities where business is done by retailers largely or entirely on a cash basis. The same situation obtains in railroad and steel mill towns where the retailer carries the wage earners from one pay day to another. Terms to the retail trade must thus be adjusted to local conditions and corresponding adjustments must frequently be made in selling to the wholesale trade. Again, wholesalers dealing in farming communities, where many of the soil tillers are carried by the retailers, must grant such terms to the retail merchant as to enable him to meet the demand of his customers for credit extensions. This observation applies with especial force at times of inactivity and business depression, such as were experienced during 1921 and the latter half of 1920.

Some concerns offer their customers the choice between two sets of terms. They may be allowed to buy, for instance, on a 15-day basis when the terms are 1/10, net 15 days; or on a 30-day basis with 2/10, net 30 as the terms of sale. In other instances, distinction is made between city and country trade. One or the other class may be favored, depending upon the keenness of competition and the convenience in making payment for both seller and purchaser.

Sectional Differences.—The distribution of income throughout the year in different parts of the country, even in a single line of trade, is a question vitally affecting both the length of the credit period and the extent to which violation of regular terms of sale may be expected. Farming, for example, is highly seasonal in the South Atlantic, South Central, and Far Western states, so that in the first two groups a typical farmer sells about four times as much in October as he does in June, while in the last group of states a typical farmer receives five times as much income from the sale of his products in October as he does in February. In both of these sections income is at a minimum during the summer months and reaches a maximum during the months of October and November. On the other hand, the diversification of farming practiced in the North Central states, including Ohio, Indiana, Illinois, Michigan, and Wisconsin, has almost eliminated the seasonal aspect from the farming industry. Although crops still mature in the summer and fall, the seasonal high points of income resulting from the sale of crops immediately after the harvest months of June, August, and September are flattened and practically offset by the heavy sales of livestock during December and January. In these states a typical farmer receives 7 per cent of his total income during February, the lowest month, and 9.8 per cent during December, the highest month, the average being 8.3 per cent of the total income.

Because of the even distribution of income in the agricultural communities of the North Central states, relatively short terms of sale to retailers located in farming communities will suffice. There would also seem to be little justification for such retailers to run beyond the usual credit period. Furthermore, an overdue account in a southern agricultural community in the month of December is a matter far more serious than a similar past-due account in December in a farming community in Illinois, for a substantial amount of income is not expected by a retailer in the South for about seven or eight months thereafter, whereas in Illinois income flows in almost evenly during the entire year and the account may be liquidated during any of the subsequent months.[1]

[1] WHYTE, JOHN, "The Diversification of Farming," *Credit Monthly*, Dec., 1923.

The Business Cycle.—All of the factors used in the determination of the credit period are greatly modified with reference to the business cycle. During periods of stress and depression, when business activity is more or less suspended, regular credit terms are often disregarded. To stimulate sales and energize business, all sorts of devices are brought into play. Credit men depart from the usual terms in favor of buyers, and sales are correspondingly increased. On the other hand, during periods of prosperity, when business is to be had for the asking, credit men are and should be more conservative and considerably stricter in the enforcement of their usual terms of sale, thereby contributing toward the prevention of undue business expansion.

The Cash Discount.—The discount used in connection with terms of sale is commonly referred to as a "cash discount," to distinguish it from "trade discounts." The former is a premium granted the purchaser for cash payment, whereas a trade discount simply constitutes an allowance or deduction from the listed price of the goods. Cash discounts are in a sense interest payments made to buyers for the settlement of accounts not yet due. They are inducements offered customers for the payment of bills before the due date. The cash discount, however, offers a rate considerably higher than the prevailing rate of interest, because of the additional advantages that are derived by the seller from such procedure.

Advantages of Cash Discounts.—When the discount is taken advantage of by the buyer, it not only gives the grantor quicker possession of the money, which can be turned again, but also reduces the credit and moral risks. Immediate use of the money tends to increase the rate of capital turnover, and less of it is required to operate the business. A great deal of credit and collection machinery can be dispensed with when all bills are discounted. Losses from bad debts are reduced accordingly, and the costs of doing business are decreased. Hence, the rate of discount frequently varies directly with the length of the credit period. Lastly, the taking of a cash discount by buyers tends to promote and maintain a spirit of good will between seller and customer, there being less occasion for friction.

Significance of the Cash Discount.—The significance of the cash discount can be fully appreciated only upon the determination of the equivalent rate of interest per annum. To determine that, the intervening period—in days—between the optional

dates of payment should be divided into 360 days—the number of days contained in a year as reckoned by banks—and the quotient multiplied by the rate of discount under consideration. To illustrate, assume that a bill of goods is purchased January 1, and that the terms are "3/10, net 30." The bill may be paid on the tenth of January and the 3 per cent discount taken by the buyer, or remittance may be made on the thirtieth, the date the account is due net. If the latter option is exercised, the purchaser indirectly pays 3 per cent for the use of the amount of the bill for 20 days—the intervening period between the two optional dates of payment. Since there are 18 times 20 days in 360 days, or a year as reckoned by banks for discount purposes, the equivalent rate of interest per annum is 3 times 18, or 54 per cent.

Cash Discount Misapplied.—For cash payment, a discount of 5 per cent is not uncommon and as high as 7 to 10 per cent are granted in some lines. On some electrical products the regular terms are "5/10, net 30." In this instance, the buyer would be paying interest at the rate of 90 per cent if the bill is not paid within 10 days. On the other hand, the grantor would be paying a similar rate when the discount is taken advantage of. An absurd situation! If the business is lucrative, chances are that the credit standing of the purchaser at the banks or in the open market would be sufficiently high to enable the concern to secure the required capital at a much lower rate. If the business is poor and unprofitable, the merchant cannot continue payments at the rate of 90 per cent on the capital employed much longer than warranted by his proprietorship equity.

The situation, as it occurs to the author, is that when cash discounts become so large as to exceed the equivalent of approximately 30 or 40 per cent per annum, they are *in fact* a combination of "cash" and "trade" discounts. These large discounts continue today largely from sheer custom. The general tendency, however, is to reduce both the cash discount and the credit period. Shortly after the Civil War the cash discounts granted were very large, partly because of the length of the customary credit period and attending credit and moral risks, and partly because of the unsettled monetary and other business conditions. The large cash discounts offered today can, in large measure, be traced to the times when the credit period consisted

of approximately six months, when transportation and banking facilities were few, stock turns considerably slower, and business and monetary conditions extremely uncertain. When large so-called cash discounts are offered today, they are intended to be taken, and the seller prices his merchandise accordingly, so that the true price is considered by the grantor to consist of the invoiced price less the portion of the discount which constitutes *in fact* a trade discount.

The Cash Discount Abuse.—A very serious matter which credit managers have to cope with constantly is that relating to the practice on the part of many buyers of taking unearned discounts. Although allowed only as a premium for cash payment within a specified time definitely stated on the invoice, or otherwise agreed upon, nevertheless many purchasers have the audacity to deduct discounts even when remittance is made long after the expiration of the discount period. This abuse has originated principally as a result of the practice which leaves the matter of taking cash premiums to the honor and good faith of the buyer. It is generally believed that no such difficulties would have been experienced if provision had been made at the outset that the buyer remit the full amount of the invoice and the seller either credit his account or return a check covering the amount of the discount in case remittance is received within a specified time. As it is, the buyer has the power to deduct the premium. The cash discount is attractive. Not wishing to lose it, he therefore makes every effort to exact it, even though it necessitates the use of threats.

Another abuse that has crept into the cash discount system is that buyers of large business organizations frequently insist upon receiving extra large discounts for cash. These unusual terms are demanded in full knowledge of their superior position as buyers on the one hand and the fear of sellers of losing trade on the other. Thus, some department store buyers make it a practice to shop for cash discounts rather than merchandise. This condition of affairs is due partly to the method employed by some stores of penalizing departments whose buyers fail to secure a specified minimum discount. If the buyer fails to receive the required discount, his department is charged with the difference between the discount obtained and the discount required. Similarly, the department is credited with any dis-

counts which are secured in excess of the required figures. This practice is known as "loading," and is regarded by the enterprises which use it as a means of making sure that all buyers secure the largest possible discounts. Another argument in its favor is that it enables executives to judge the abilities of various buyers on a uniform basis. Because of this practice, hard and unusual terms are demanded of sellers, with the result that the cash discount system is greatly harmed and sentiments are thereby created for its abolishment.

The effect of the cash discount abuse may be shown by the following quotation from a leaflet of the National Association of Credit Men:

> If the seller of merchandise is not strict with his customers about the observance of cash discount terms and uses this indulgence as a selling feature, to patronize such sellers for the sake of such indulgence places a premium on unfair discrimination and encourages forms of recoupment that do not show on the surface, yet should be apparent to the buyer when he considers that the same values and treatment may not reasonably be expected if the cash discount in one instance has to be taken within a specified time, and in another instance may be deducted whenever he is pleased to remit. Trading on a cash discount induces demoralization in business, and if a buyer of merchandise makes it a custom to take the discount whenever he pleases and not according to the terms of the purchase, he will unconsciously drift into other bad methods that may eventually impair his prospects and affect his abilities to buy at the best prices.
>
> When a seller of merchandise, fearing the threat of a buyer who demands the cash discount after the expiration of the discount term, allows the premium, there is encouraged thereby a come-back to offset the deduction and nothing, perhaps, is so detrimental to business or in the intercourse of men in the credit relation, as the secret allowance of unjust and unfair deductions.

To remedy the situation it becomes essential that sellers insist upon the closest observance of cash discount terms. They should point out to buyers that cash discount terms are contract terms which are taken into consideration as a definite item in a determination of the prices at which merchandise should be sold, for premiums for cash are too large "and mean too much in dollars and cents to be given as many interpretations as there are buyers."

TERMS OF SALE CLASSIFIED[2]

Terms in any given trade are often referred to as "usual," "common," or "regular," meaning thereby such terms as are considered well established and general in the trade under consideration, and fixed by custom or contract, and sometimes by resolution of an associated group in the trade. It should also be kept in mind that the accepted usage is to commence to count the period of credit extension from the date of shipment or invoice of the order, and not from date of receipt of the goods by the buyer, unless R.O.G. (receipt of goods) terms are agreed upon by the contracting parties.

The customary terms of sale in mercantile transactions consist of C.B.D., C.O.D., Cash, "Ordinary," E.O.M. and M.O.M., Proximo, R.O.G., "Extra" or Dating Ahead, and Season Dating terms.

C.B.D. and C.O.D. Terms.—C.B.D. (cash before delivery), or cash with order, terms are applied to bad risks when the seller is unwilling to extend any credit whatever. Under these terms no credit is extended and no risks are assumed by the seller. The terms are rather uncommon, since C.O.D. (cash on delivery) terms are usually employed instead. If the purchaser refuses to accept the goods unless credit is extended, the seller, of course, must have the goods returned, and thus lose the freight both ways, and perhaps suffer on account of deterioration of the products while in transit, or else resell the bill of goods to another customer in the locality of the original consignee or thereabouts. C.O.D. terms are, therefore, a poor substitute for C.B.D. terms and must not be used unless some confidence is had in the purchaser, or unless a deposit is made by the buyer sufficient to cover the freight charge. Practically all houses in the various lines apply C.O.D. terms on sales to poor risks and slow-pay customers, except in trades in which these terms are "regular."

Occasionally terms are quoted "S.D.-B.L.," meaning thereby that a sight draft to which the bill of lading is attached must be honored before delivery. This arrangement closely resembles C.O.D. terms, and may be said to constitute one way of enforcing them. Carload shipments of flour are frequently made against arrival draft with bill of lading attached. S.D.-B.L.

[2] For complete list of customary terms of sale, see Appendix.

terms also apply to sales of hides and skins, grain, carload shipments of canned meats and lard, lumber, and many other products.

"Cash" Terms.—Most establishments do a certain amount of "cash" business. The credit period of a "cash" transaction may be as high as 14 days, *i.e.*, a transaction is deemed by some concerns to be consummated on a "cash" basis if payment is made within the number of days specifically or impliedly agreed upon, which usually amounts to a week or 10 days. The discount is naturally absent when goods are sold on "cash," C.B.D., or C.O.D. terms, since no option is to be exercised by the buyer as to the date of payment and consequently no inducement is required to obtain the remittance of accounts.

Ordinary Terms.—Terms involving no special features, such as datings and extras, are, for lack of a better name, termed as "ordinary." They consist of nothing but the two component parts of terms of sale—the credit extension, and the cash discount—both simply and definitely stated. In many lines, sales are made on "2/10, net 30" terms (2 per cent, 10 days, net 30 days). This means that if the bill is paid within 10 days from the date of invoice, a deduction or discount of 2 per cent from the face of the bill is allowed, and that the bill becomes due at the end of 30 days from the date of invoice or shipment. It is optional with the buyer, who may either pay in 10 days or else make remittance in 30 days and void the discount privilege. These are the regular terms in the grocery trade, on certain petroleum products, on some automobile accessories, and many other articles. In the hardware trade the usual terms are "2/10, net 60 days"—also of the ordinary type.

E.O.M. and M.O.M. Terms.—Both E.O.M. (end of month) and M.O.M. (middle of month) terms are special forms of datings. All shipments made during any one month are dated as of the first of the month following, if E.O.M. terms apply. M.O.M. terms are an amended form of the former, in that goods shipped between the first and fifteenth of any month are dated as of the fifteenth of that month and those shipped between the fifteenth and the end of the month are dated as of the first of the month following, the terms beginning to apply on the fifteenth and first, respectively.

The primary purpose of both of these terms is to accommodate "running" accounts, where the purchases are relatively small

and frequent. It is convenient for the buyer to settle once or twice a month for all of his purchases from any one house instead of making the daily settlements which would otherwise have to be made in order to take advantage of cash discounts. It also adds to the convenience of the seller from the standpoint of bookkeeping.

However, the practice is subject to serious abuses. There is danger that sales will slump toward the end of the month unless the seller is persuaded to date the shipments as of the following month, thus extending the credit period by 30 days. Some customers may insist for various reasons that their purchases be billed as of the first of the month following when goods are bought toward the end of the month, thereby forcing the seller to discriminate between customers. Both of these terms are to be looked upon with suspicion, since their tendency is to lengthen the credit period and to increase the risks correspondingly.

Proximo Terms.—These terms are employed to a considerable extent by coal jobbers, automobile accessory jobbers, wholesalers dealing in electrical products, and many other houses. Under them, payment for all purchases made during any one month is to be made on a specified date in the month following. They differ from E.O.M. terms in that the latter may be stated as 2/10, etc., E.O.M. under which circumstances the 2/10 do not begin to apply until after the first of the month following, whereas, when proximo terms are stated, a definite date for payment is usually specified, such as the tenth, fifteenth, twentieth, or twenty-fifth.

In certain cases where proximo terms are employed, anticipation at from 6 to 8 per cent per annum is provided when the bill is paid before it becomes due. A similar rate is usually charged on overdue accounts.

R.O.G. Terms.—Refined sugar is sold to wholesalers by manufacturers on "2/7, R.O.G." terms, which means that a discount of 2 per cent is to be taken by making payment within seven days after "receipt of goods." Thus the time allowed for discount purposes is measured from the date the shipment arrives. The prime object in employing these terms is to meet and overcome objections of distant purchasers who are at a disadvantage in taking discounts as compared with buyers close to sources of supply. As indicated in another connection, all invoices, with few exceptions, are dated the day goods are shipped

and the credit period is measured from that date. A supply house located in the eastern part of the country with selling connections throughout the nation must, of necessity, employ R.O.G. terms if competition of distant houses is to be met effectively and all purchasers are to be treated alike with respect to terms of credit. It is obvious that a purchaser located within a short distance from the supply house would enjoy a distinct advantage over a customer in the far west. If the discount must be taken within 10 days, assuming that both buyers will take advantage of it, the former would have sufficient time to check up his purchases and even sell some of the goods prior to making payment, while the latter would have to pay long before the goods are received. It should be noted that the benefits from R.O.G. terms are enjoyed by the purchaser only when the bill is discounted. If the discount is not taken advantage of within the stated period, the regular credit terms are measured from the date of invoice, as if no special terms had been extended.

"Extra" or Dating Ahead Terms.—Under these circumstances the terms of discount do not begin to operate until the expiration of the "extra" period. Thus, one finds the terms in the dry goods jobbing trade expressed as "3/10, 2/10-60," or "3/10, 2/10-60 extra." Not infrequently they are stated as "3/10, 2/70," or "2/30, 30 extra." These terms are also often expressed as "2/10-60," or "2/10-60 extra," in which instance there is 1 per cent anticipation. In each of the cases cited above the terms of the so-called cash discount do not begin to operate until the expiration of the "extra" period, which amounts to 60 days in all but one instance. Accordingly, if cash is paid in 10 days from date of invoice, a 3 per cent discount is allowed as a deduction from the gross amount of the bill. If the amount is paid 10 days after the "extra" period, or at the end of 70 days from date of shipment, the customer is allowed a 2 per cent discount. In many cases the practice is to allow the purchaser a certain rate of interest on the *net* amount due if payment is made after 10 days from date of shipment, but before the expiration of the 70-day period. The interest covers the period between the date of remittance and due date and varies from 6 to 8 per cent per annum.

Upon a close examination of the terms, the reader will readily concede that, for all practical purposes, the only true *cash* dis-

count under these terms consists of 1 per cent of the gross amount of the bill taken only when remittance is made within 10 days. The other 2 per cent is an evasion and a misnomer and not in keeping with the true meaning of the term "cash discount." The 2 per cent is but a "trade discount," a reduction from the listed price which has been first "marked up" so as to allow a "mark down" in the form of a 2 per cent so-called "cash discount." The bill becomes due at the end of 70 days and the 2 per cent discount is then taken as a matter of course. The 2 per cent does not possess any of the characteristics of a cash discount. It is not a privilege to be exercised at the option of the buyer. It is not an inducement in the sense in which a cash discount is employed. Payment is due at the end of 70 days and the bill *must* be paid—the gross amount less 2 per cent, which is, as already indicated, a trade discount. It is said that the practice originated when the 2 per cent was offered as a cash discount and the bill did not become due until 90 days, but since the "net 90 days" part of the terms was dropped and eliminated and not even anticipated in most instances, hence the change in the purpose and nature of the 2 per cent involved. Thus, when the "extra" or dating ahead terms are simplified and the mask torn off, they would be expressed as "1/10, net 70 days."

Season Dating Terms.—Season datings constitute merely an extension of the credit period, similar in nature to any other sort of dating ahead. The season dating is made necessary because of the unwillingness of manufacturers to carry the entire burden incident to unfavorable changes. Wholesalers are thus frequently required to place their orders with the manufacturers or importers ahead of production or importation, which often embraces a period of at least seven or eight months. In the meantime a number of things may happen. Business in general may decline, or the demand for the goods ordered may slump or cease entirely, on account of changes in style and the like. Prices may fall, due to the downward movement of the business cycle, and numerous other uncertainties may add to the risks involved in ordering in advance. Season dating is a device to induce retailers to share the risk and carry part of the burden incident to the advance ordering of a stock of goods. By such arrangements responsibility is at least partly shifted from the wholesaler to the retailer. In like manner is the risk burden

partially shifted by the manufacturer or importer onto the shoulders of the jobber and functional middleman.

The length of the season dating period varies considerably in different lines and houses. Spring and summer goods, for example, sold and delivered any time after January 1, in the dry goods trade, are dated as of May 1, after which the discount terms begin to apply. Rubber boots and shoes are generally marketed by jobbers on a December 1 dating, with delivery commencing with the month of April, thus allowing a maximum of eight months as a season dating. Usually these datings vary from one to four or five months. Season dating terms are used by practically all houses dealing in seasonal products. Business men not infrequently refer to these terms as "terms on futures."

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CHAPTER VI

THE CREDIT MANAGER

Evolution of the Credit Profession.—From the standpoint of responsibility in credit work organization and management, the history of its development may be divided into three periods. During the first period the responsibility for dispensing credit devolved on the proprietor or the head of the firm, who was personally in touch with his comparatively small number of customers and, consequently, familiar with the essential facts governing the determination of his credit policy. In the average small business establishment the credit work is even yet performed by the proprietor or head of the firm, who may, in addition, have complete charge of other functions, such as buying, advertising, merchandising, financing, and general office management.

In the second stage in the development of the credit manager, credit-making power was delegated, though with great reluctance, to the bookkeeper, and in retail establishments, to the cashier-bookkeeper. With the complete recovery from the panic of 1873 and the business depression which followed it, the proprietor or head of the firm found it beyond his ability to interview new applicants for credit personally and to supervise all work related to credit granting. The period of personal observation of customers and their businesses has passed and indirect and impersonal contact substituted. During this period the country progressed and developed rapidly—the far west was opened up, the financial and commercial reconstruction made necessary by conditions growing out of the Civil War and the crisis of 1873 was almost completed, the influx of immigrants was unusual, and accounts of individual houses grew by leaps and bounds both in number and amount. The sudden and enormous increase in the volume of business necessitated the adoption of some form of organization with powers delegated to officials in responsible positions. Under these circumstances it was impossible for the proprietor to maintain contact with the trade

and acquire an accurate knowledge concerning credit customers. Accordingly, the responsibility for dispensing credit, although primarily devolving upon the bookkeeper, was not infrequently shared by other individuals. In addition to the manager and owners, salesmen were still relied upon in the selection of credit risks, principally because of their direct contact with the trade. It was a period of mixed responsibility, as far as credit granting was concerned.

The formation of the National Association of Credit Men in 1896 marked the beginning of a new era in the evolution of the credit expert. As trade grew and developed still further, the bookkeeper found it beyond his ability to handle both accounting records and credits successfully, for credit work alone required, in the majority of instances, the entire time of one or more persons. Thus it came to pass that credit work was finally placed in the hands of a special man, more or less of an expert, whose function it was not only to select the risks carefully, but also to supervise accounts constantly, collect bills promptly, and the like. To be sure, this expert, though considered indispensable, was at first in many instances given a rather inconspicuous place in the organization. This he still occupies in some of the smaller businesses which have not as yet expanded sufficiently to realize the importance of his services, for, it is to be noted, the three stages in the evolution of the credit profession apply to expanding businesses even today. These stages are characteristic of large concerns from the standpoint of time and of small enterprises from the standpoint of size in their growth.

Importance of the Credit Manager.—The credit manager occupies a unique position in business, one which is difficult to fill successfully and creditably. He is held responsible for losses arising from bad debts and at the same time required not to refuse too many applicants for credit and thereby turn away business. He is either responsible for practices resulting in losses from accepting doubtful accounts or in volume of sales through liberal refusals of applications for credit. Again, when buyers are given credit sparingly and prompt payments are insisted on, merchants will not overstock their stores with unsalable merchandise; while failure to insist upon prompt collections, coupled with extreme liberality in granting credits, invariably results

in glutted markets, poor merchandising, and perhaps ultimate failure of the credit giver.

The credit manager, it will be seen, is, in a sense, the financial officer of the concern he represents. He constitutes an important thinking part of the enterprise. The credit desk is the natural center to which all sorts of information gravitate and where many important facts bearing upon the business are registered. Obviously, the credit department has a much wider field than merely preventing losses. There are, therefore, great opportunities for gaining all sorts of knowledge, particularly financial knowledge, and for general and rapid advancement. The credit profession is still in its infancy, but is rapidly growing to vigorous youth, and with the passage of time its importance will be more keenly appreciated—therefore the greater the possibility for those who were fortunate enough to enter the profession early as well as those who possess the background which qualifies them for this all-important position.

ESSENTIAL QUALIFICATIONS OF A CREDIT MANAGER

Adaptability.—According to a writer on credits, of much experience, adaptability for the work is one of the principal qualifications of a credit manager.[1] A credit man is not born and is not so much the result of inheritance as he is a product of training. To succeed in his work, a credit manager must have a love for it, which, to be sure, may be cultivated.

All work may be divided into two classes or types: There is the kind of work that the average person considers unpleasant, such as mining, running a machine in a factory, driving a truck, running a typewriter in an office, and the like. This type of work embraces all the unpleasant and purely machine-like industrial processes and the dull routine work, all of which are essential to our complex existence. People are compelled to perform these duties in order to gain a livelihood. Other people regard work as pleasure. In this class are included most professional persons, such as lawyers, doctors of medicine, and others. Where the work is unpleasant, many difficulties in the form of strikes, inefficiency, and other disturbances are experienced. Wage earners for the most part feel the urgency for work solely as a means of obtaining enjoyment in their spare hours. Ac-

[1] Tregoe, J. H., "The Credit Man," lecture prepared for the National Institute of Credit.

cordingly, demands for higher wages, shorter days, and better conditions with respect to environment are continuously made of employers, and the possibilities are that so long as work is regarded as a necessary evil so long will the performers remain partially dissatisfied. On the other hand, professionals, including attorneys, doctors, scientists, and the vast group of business men, in addition to the compensation they receive in terms of money, derive no little satisfaction from following a chosen line of endeavor and from serving humanity in general. Adaptability is, therefore, the fitness of a person to the requirements of his position.

Thoroughness.—This is perhaps the chief quality in credit granting and in collection procedure. To succeed, a credit manager must not jump to hasty conclusions. Risks should be thoroughly investigated and decisions based upon accurate knowledge of facts. He must scrutinize the information secured from the various sources available, since apparently insignificant items might have an important bearing upon the nature of the risk. He must constantly watch for the out-of-the-ordinary, such as opening up accounts in new markets, failure to take advantage of cash discounts, and the like.

To be thorough does not necessarily involve the need of going into great detail. It does mean, however, that a task must be so performed as rightly to deserve the designation of completeness. By properly centering his attention on one thing at a time, the credit dispenser can analyze conditions thoroughly and yet require little time and effort for the process.

Even Temperament.—A successful credit manager must be of even temperament and not affected from day to day by personal feeling and mental attitude. Evenness of temper and coolness of judgment are two indispensable requisites in the profession under consideration. Unpleasant occasions in and outside of business frequently arise, to the influence of which credit grantors must be immune in exercising their judgment. When orders are declined on the basis of information secured and interpreted by the credit department, the sales force may be disappointed. On the other hand, when orders are accepted on its advice, and losses are consequently suffered, the management is very likely to place the blame on the credit department. The credit manager is often in a precarious position which requires good, sound

business judgment and an extremely even keel. He cannot afford to be a pessimist one day and an optimist the next.

Firmness.—A credit manager should be firm in his decisions and in executing policies. He will often be criticized and prevailed upon by the salesmen, sales manager, customers, and others, but should nevertheless adhere to his conclusions, unless additional facts are presented which would tend to modify the original decision. He should be firm and yet not stubborn, progressive in his attitude, willing to learn at all times, possess an open though critical mind, and change his attitude only when warranted by additional evidence in the case.

Quickness of Decision.—This qualification is particularly desirable in a retail credit manager, where deliberation and undue slowness in appraising circumstances may mean a loss of trade. Some risks are extremely sensitive and resent any delays on part of credit men in passing judgment, and deliberations are interpreted as a slight. A credit manager must, therefore, be resourceful, quickly appraise given conditions, and effectively handle them.

FUNCTIONS OF THE CREDIT MANAGER

The precarious position of the credit manager has already been referred to in a previous discussion. His primary function is to keep the percentage of losses at a minimum. However, a low percentage of losses from bad debts alone is not a sufficient criterion of a successful credit manager, for losses can be kept at a low point by refusing all but premier risks. In doing so, much profitable trade is driven away from the house. Furthermore, it would hardly require the superior knowledge of a specialist such as portrayed merely to distinguish between merchants whose credit standing is reliable beyond any shadow of a doubt and those whose credit standing is not of the first class. The inauguration of too strict a policy invariably results in the refusal of much valuable business, the profits from which may greatly exceed all possible losses from bad debts. On the other hand, great liberality in accepting doubtful accounts means a loss in excess of the profit derived from such trade. It, therefore, devolves upon the credit manager to exercise nice judgment in so managing his work as to have a minimum of losses with a maximum of sales.

Reduce Losses.—To attain the double object of reducing losses to a minimum and at the same time increasing sales volume, the credit manager must first of all exercise special care in the selection of risks. Upon receipt of an application for credit, the risk should be thoroughly investigated and adequate information gathered and carefully analyzed. Should the applicant fail to measure up to the standards of the house, the credit manager should not hesitate to decline credit, for by extending credit liberally to merchants who are incompetent and whose standing does not warrant such treatment, the whole credit system is abused and irreparable injury results to business and credit standards.

Conditions affecting the credit standing of customers are continuously changing with the variations in local conditions and general oscillations of the business cycle. Profits may decrease, or the customer may overexpand his plant or overstock with unsalable merchandise. For this reason, the activity and progress of both old and newly opened accounts should be watched carefully. Records should be revised periodically and kept up to date. The results of these periodic revisions will indicate whether the limits of credit established should be continued, increased, decreased, or altogether discontinued. Unpleasant surprises will thus be avoided and weaknesses probably discovered in time, so that even in the worst case the account may be carefully eliminated if in the opinion of the credit manager the weaknesses disclosed are of a permanent and incurable nature. On the other hand, if the weakness is temporary, it might be advisable for the creditors to lend their assistance in an attempt to rescue the debtor and restore the account to its former position.

The business conditions in a community determine, in a way, the prospects of safety in extending credit. Local conditions affecting different parts of the country in which customers and prospects are located must be diligently studied. A community may be industrially and financially in its youth, maturity, or old age. It may be on the up-grade, down-grade, or at a standstill. To grant credit freely to individuals or merchants in a down-grade stage of a community is to invite failure. Other conditions affecting different localities in which the house is interested should be studied. If the sphere of interest is a farming community, crop conditions and other important factors

relating to agriculture must be given adequate consideration. Knowledge of all of these industrial factors, coupled with an intimate acquaintance with the character of the people themselves, will prove an invaluable aid to the average credit manager in the extension of credit accommodations.

In addition to a study of local trade conditions, the credit manager should familiarize himself with all the elements combining to spell success or failure of the respective businesses of his customers. He should know the nature of the businesses they are conducting, probability of success or failure, financial strengths of the enterprises, efficiency of the managements, and local competitive conditions affecting them. In a word, everything which goes into the composite of the three C's, which will be discussed in the following chapter, must be known if the functions of reducing losses and increasing sales are to be well performed.

Another part of a credit manager's task lies in the application of his skill in making collections. Delinquent debtors are to be followed up vigorously and persistently and knowledge must be had as to the different steps that may be taken in forcing the payment of past-due accounts. As will be shown in Part IV, this phase of the work requires an intimate knowledge of the legal remedies of creditors, adjustments, compositions, receiverships, bankruptcy, and the like. Above all, it calls for an unusual degree of tact and diplomacy and strategy of a very high order, for, after all, the human equation is all-important in both credits and collections.

Increase Sales Volume.—The second important function of the credit manager is to stimulate sales, by working in harmony with the sales department, but primarily by creating and maintaining the good will of the trade. If his duties are intelligently and conscientiously performed, he will not only win the customers' entire business in the lines handled over to his house, but will also become a significant factor in the development of their ability as merchants. The latter will strengthen his customers' positions in their respective local fields and larger sales will thus be obtained.

Cooperate with Other Credit Departments.—A third function of the credit manager is to cooperate with other credit departments either directly through interchange of credit information in response to inquiries, through personal interviews,

and group meetings; or, indirectly, by furnishing information concerning credit risks to mercantile agencies and credit interchange bureaus. The knowledge of a credit manager cannot be considered an asset until it is put into circulation and shared with others in the profession.

It is probable that no other form of business activity is so dependent upon collective action and cooperation as is credit work. As a result, the need for an exchange of ideas and experiences is so universally recognized that credit information is readily imparted by one merchant to another. The wisdom of years of experience has burned the necessity of cooperation into the very soul of credit men's organizations. The mutual benefits derived from the interchange of credit information and cooperation are so widely recognized that many credit managers possessed of the true cooperative spirit are deterred from acting independently even in cases of liquidations and bankruptcies, where preferences could be readily secured and an immediate gain obtained.

It is a big task to harmonize all credit managers into one smoothly working cooperative organization, but if one is to judge by the steady progress since the formation of the National Association of Credit Men, future prospects for cooperation in credit work are rather bright.

Index to Credit Department Efficiency.—As a general rule, a credit department's efficiency is judged primarily by the manager's skill and ability to reduce losses incurred from bad debts due to failure to collect doubtful accounts to a minimum. However, an exceedingly small loss record alone constitutes, in fact, an inferior basis, since it is a comparatively simple task to accomplish such a feat by practicing conservatism to the *n*th degree and accepting only A-1 risks, thereby diverting trade to competitors and depriving his own house of possible business profits which would have, perchance, exceeded the losses incident to the assumption of a more liberal attitude on the part of the credit manager.

To illustrate, let us assume that orders for $1,000,000 worth of business are received during a given period by the credit departments of three competing houses. Let us further assume that the first concern, A, pursues a rather conservative policy and rejects 50 per cent of the business; that the second house, B, follows an extremely liberal policy and rejects only 10 per

cent of the business submitted; while C, the third house, steers a middle course and rejects 20 per cent of the orders. For purposes of comparison, it is also assumed that the percentage of net profit prior to the deduction of bad debt losses is the same in all three instances, namely, 5 per cent. The results of the difference in credit policies are indicated below:

A. Ultra Conservative Policy

Business accepted	$500,000
Profit prior to deduction of losses	25,000
Bad debt loss (two-tenths of 1 per cent)	1,000
Net Profit	$24,000

B. Too Liberal Credit Policy

Business accepted	$900,000
Profit prior to deduction of losses	45,000
Bad debt loss (1.6 per cent)	14,400
Net Profit	$30,600

C. Ideal Credit Policy

Business accepted	$800,000
Profit prior to deduction of losses	40,000
Bad debt loss (one-half of 1 per cent	4,000
Net profit	$36,000

These illustrations show that the first house has kept its losses down at the expense of possible profits from an increased volume of sales; that the second house, by pursuing too liberal a credit policy, incurred a loss entirely out of proportion, yet it fared considerably better than the first concern. The third house, however, by steering a middle course, reached the ideal of securing a maximum of business profit with a minimum of loss.

In view of the foregoing illustration it is suggested, therefore, that in order to test the efficiency of a credit department where comparisons with departments of competing houses is impractical, figures such as those presented in the preceding illustration be compared for a period of years. Specifically, the test should include the following items:

1. Amount of business received
2. Amount of business accepted
3. Business lost in orders rejected
4. Percentage of bad debt loss.

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CHAPTER VII

THE CREDIT RISK

Every credit transaction involves the element of futurity, *i.e.*, a promise to pay in the future in exchange for a present consideration. There is, therefore, more or less risk whenever goods or services are sold on time and it is not an ordinary task to determine in just what degree the risk is present in any given instance. One of the chief functions of the credit manager is to determine whether the application for credit is to be accepted or turned down. To do this, he must search for and obtain sufficient evidence, an examination of which will either prove or disprove the existence of willingness and ability on the part of the credit seeker to make payment at the expiration of the credit period. Without any likelihood of the applicant's being both able and willing to pay the bill at maturity, no credit should be extended, lest the losses incurred from freely accepting doubtful accounts exceed the profits incident to increase sales.

BASIC FACTORS DETERMINING THE CREDIT RISK

In preferring one applicant for credit over another, a process of elimination must necessarily be carried on. This process is based upon information considered essential for the judgment of the grantor in the selection of his risks. If confidence as to the customer's willingness and ability to pay is thereby established, the risk is accepted; otherwise it is turned down. There are at least two decisions involved in the consideration of applications for credit. First, shall credit be granted? Is the risk good? Second, assuming the first decision to have been made in favor of the credit seeker, to what extent shall credit be extended? What limitation shall be placed upon it?

The principal factors to be taken into consideration in deciding whether or not credit should be extended and in what amounts comprise what are commonly referred to by men in the credit profession as the "three C's"—Character, Capacity, and Capital.

Character.—By "character" the credit grantor understands honesty. It is a barometer of a person's willingness and intention to pay his bills when due and discharge his obligations promptly. The applicant's character may be revealed in his antecedents, in his standing in the community, his habits, and moral principles. Obviously, a person's character is not subject to frequent changes. An investigation should, therefore, never fail to include a customer's general history, reputation, and similar factors bearing upon the moral aspects of the risk.

Although character is the least tangible of the factors in the determination of the credit risk, it is nevertheless *normally* the most important basis and is susceptible to definite ascertainment. It is not extremely difficult, for example, to discover and separate the honest from the dishonest, the sane livers from the extravagant, the abstainers from the drinkers and gamblers, and the moral from the immoral. Experience has shown that capacity and capital count for little when a clever crook deliberately determines to "beat" his creditors. Where character is doubtful or distinctly inferior, no credit should be extended if the purchase of a lawsuit is to be avoided.

According to the testimony of the late J. P. Morgan a few years ago before a committee of Congress investigating the Pujo Money Trust and other economic conditions, character is of prime importance in the selection of credit risks. As much as a million dollars was extended by him to a single person on this basis alone. He also stated that a "man with character, without anything at all behind it, can get all the credit he wants, and a man with the property (but without character) cannot get it."[1] The character element doubtless does frequently constitute the most significant factor in the determination as to whether or not credit should be granted, with the exception of banking credit, which is often based on collateral. It is doubtful, however, whether many credit managers would assign character such an exaggerated and envious position in the course of normal business activity and part with their goods on this basis alone. Character merely determines whether the credit risk is good and honest and probably affects 30 per cent of the credit decision.

Capacity.—To ascertain the credit seeker's ability to redeem his pledge at maturity, his capacity in all of its phases must be

[1] Pujo Money Trust Investigation, vol. 2.

thoroughly investigated and appraised. From the standpoint of retail credits, capacity is judged by one's ability to earn enough to pay for his purchases, or the ability to get ahead as determined by earning power, the consistency with which the customer holds his position or the efficiency with which he conducts his business, if in business for himself. From the standpoint of banking, and particularly mercantile credit, capacity connotes efficiency. It is ability of the merchant, native or acquired, to conduct his business at a profit. Other things being equal, the far-sighted, able, and aggressive business man is more likely to succeed than the short-sighted, narrow-minded, and easy-going individual.

Capacity may be reflected primarily in the customer's knowledge of his business, technical and otherwise, alertness, shrewdness, and ambition. A person's age is usually a reliable index to his progressiveness and conservatism. Again, the inexperienced man "going into business for himself" is greatly handicapped and the chances of success are much against him, unless sufficient experience in the given line has been previously acquired with similar establishments and a reasonable amount of capital has been accumulated to carry the undertaking through the experimental stage. Finally, buying and selling methods and policies and general business management are important considerations in an attempt to ascertain the presence or lack of capacity or ability to make good. Definite knowledge can be gained concerning these matters from records showing the credit seeker's antecedents, paying habits, and the extent to which modern business methods have been adopted in the management of the business.

Under normal business conditions, capacity is next in importance to character, for, other things being equal, the able, experienced, healthy, and aggressive person has a greater chance to succeed than the one who lacks business ability, is inexperienced, sickly, and easy-going. This element should be given a rating of at least 25 per cent of the credit decision.

Capital.—The third "C"—capital—determines the actual means of payment at the time the transaction is consummated. Without the financial strength as denoted by the term, the granting of credit constitutes a "moral risk," meaning thereby that the grantor relies chiefly or entirely upon the character and capacity of the risk. When coupled with capacity, capital furnishes a satisfactory answer to the query relating to the

limitation which should be placed on the amount of credit to be extended.

Capital, for credit purposes, is the financial strength of the risk; it consists of the amount and quality of goods and property, expressed in terms of money, which an individual or firm possesses in excess of what it owes. It is the margin of safety or the cushion with which the credit manager is particularly concerned, and this is reflected by the amount of assets and liabilities, their various qualities and proportions. The financial strength can be accurately ascertained by securing and carefully analyzing property or financial statements indicating the relationships between the various assets, liabilities, and proprietorships.

While wealthy debtors can be forced to pay eventually, it is hardly desirable to accept a risk with capital as the only basis to recommend it. Forced collection is too expensive a process and the eventual loss of good will as a result is a sufficient deterrent to prevent drastic action from being taken. For these reasons, capital is usually assigned a third place in the relative estimation of the three C's, except where large loans are extended, for the assumption is that capital of the right quality and proportion normally produces capacity, although it is equally true that capacity, connoting efficiency, also produces capital. Obviously, the relationship between the two is a very close one.

Collateral.—A fourth C, frequently employed in testing the credit seeker's claim to be considered a desirable and acceptable risk, is collateral. A bank making loans on security examines carefully the nature of the collateral offered on deposit, irrespective of the moral responsibility of the borrower. In selling automobiles to the ultimate consumer, chattel mortgages are frequently taken by the seller as security behind the promissory notes for the unpaid balances. In such instances, the chattel or chattels offered as collateral must be thoroughly scrutinized, for it is the property thus conveyed upon which main reliance is placed in financing the transaction. Under these circumstances, even character assumes a position of secondary importance. Normally, however, the fourth C is totally lacking in most mercantile and retail credit extensions.

Relative Importance of the Three "C's".—The relative grouping and significance of the three C's are in large measure determined by the angle from which these factors are viewed, as well as the philosophy underlying the given viewpoint. A

writer of considerable experience in credit work assigns capital the most important position, with capacity placed second, and character third. Two reasons may be advanced in justification and support of such a valuation. In the first place, it is argued that, to begin with, a credit seeker must display sufficient financial strength of his own to finance the volume of business he expects to do. Once this fact is adequately demonstrated, the applicant must convince the credit grantor of his ability to conserve his financial resources through conservative management and that he will discount his bills or meet his obligations at maturity. Finally, the applicant must display qualities of honesty and integrity, denoting willingness and intention on his part to fulfil his obligations to creditors, irrespective of contingencies that might arise, calling for action to the contrary if a line of least resistance is to be pursued.

The principal objection to such reasoning lies in the fact that relatively few credit seekers are likely to qualify in the demonstration of sufficient capital to finance the entire volume of business. Furthermore, if an individual or firm should ever attain such an enviable position they would hardly need to enlist the financial aid of supply houses and bankers, but would be buying totally on a cash basis. It follows, therefore, that a credit manager must, in practice, reverse his reasoning as indicated in the foregoing discussion and not place "the cart before the horse." He must determine: first, the applicant's willingness to discharge his obligations promptly, as determined by his character, or honesty and integrity; second, his ability to live up to his intention as reflected by his present financial standing and his ability to conserve it, or by his capacity to conserve the proceeds from the sale of merchandise secured on credit terms, and so to carry on his business as ultimately to accumulate larger capital.

Another argument in support of the transposition of capital to first place as a basis for credit extensions is that almost 75 per cent of the orders in most houses are accepted on the basis of mercantile agency ratings alone, and that only 25 to 30 per cent of the orders fall into a separate class requiring careful scrutiny of the other two elements or bases, namely, capacity and character.

In advancing this argument, the assumption apparently is that mercantile agency ratings reflect financial strength ex-

clusively. As a matter of fact, the ratings also indicate paying habits and general character, as well as capital strength. Besides, in determining the relative value of the various bases, it is not the A-1 risks that are kept in mind. These seldom give any worry or anxiety to sellers, and the passing upon such risks would hardly justify the employment of an expert. What a credit manager, or credit expert, is concerned with primarily is the doubtful or border-line account, for it is this kind of risk that calls for nice judgment and the exercise of extreme care and caution and the display of all the fine qualities a credit manager should possess. In a word, it is not the *total number* of risks, but the number of *doubtful accounts*, accepted on a given basis, which should govern the determination of the relative position of that basis or factor. A quantitative index alone falls short in an attempt to convince one of the propriety of placing capital in the premier position as a factor in the credit decision, for it is the qualitative analysis which is the more important in this connection.

To enable the credit man who strives for exactness in his decisions to measure the risk mathematically, it is suggested that, because of the reasons advanced in the previous discussion, character be assigned a value of 30 per cent; capacity, 25 per cent; and capital, 25 per cent; making a total of 80 per cent for the three C's. The remaining 20 per cent of the credit decision should be assigned to the outside forces, which will be discussed in the following paragraphs under the heading of "Modifying Elements Determining the Credit Risk," and which are in most instances subject to control. This comprises a consideration of the ups and downs of general or territorial prosperity, sudden changes in the supply or demand of raw materials, changes in laws and regulations, and various local conditions affecting the risk under consideration favorably or adversely.

The Credit Equation.—Assuming normal transactions under normal economic conditions, the credit equation may be stated in the following manner:

Character + Capacity + Capital = Safety in Credit Limit.

To indicate more clearly the relative significance of the three factors, several other equations may be developed as follows:

1. Character + Capacity + Insufficient Capital = Fair Credit Risk
2. Character + Capital + Insufficient Capacity = Fair Credit Risk
3. Capacity + Capital + Impaired Character = Doubtful Credit Risk
4. Character + Capacity − Capital = Limited Success
5. Capacity + Capital − Character = Dangerous Risk
6. Character + Capital − Capacity = Inferior Credit Risk
7. Capital − Character − Capacity = Distinctly Poor Risk
8. Character − Capacity − Capital = Inferior Credit Risk
9. Capacity − Character − Capital = Fraudulent Credit Risk.

MODIFYING ELEMENTS DETERMINING THE CREDIT RISK

In measuring credit with a view to ascertaining the risk involved as evidenced by the three elements of character, capacity, and capital, credit managers differ widely in estimating their relative importance. Not infrequently do the same credit grantors vary their own opinions as to the relative strengths of the chief and basic factors by which risks are measured, with the general trend of business conditions, and the like. For these reasons, additional factors may be introduced the effect of which is to modify the credit equation as declared operative in the majority of cases under normal economic and business conditions. These are:

1. The credit policy of the house
2. The attitude of the credit manager
3. The business cycle.

Policy of the House.—In deciding whether or not a risk is acceptable, the credit manager must be governed in large measure by the policy of his house. It is a matter of common knowledge that the percentage of net profit on which different houses in various lines, or even in the same trade, operate shows a marked variation. It naturally follows that longer chances can be run by concerns whose margin of profit is high than by those whose margin is exceedingly narrow. A liberal policy in relation to credit granting may justly and profitably be adopted by the former, whereas a similar plan when followed by the latter may prove disastrous. Again, an industry operating on

a decreasing cost basis will find it to its advantage to secure volume through liberal extensions of credit, thereby increasing the scale of operation and making for the economies resulting therefrom.

As a means of meeting and overcoming competitive conditions, liberality in the formulation of a credit policy is commonly employed. On the other hand, monopolistic or semi-monopolistic enterprises are seldom, if ever, liberal in the adoption of a general credit policy, unless it could be clearly demonstrated that the effect of such procedure would be greater sales, large-scale production, and consequently higher profits.

The type of its customers must also be considered by the house in formulating its policies. When one is selling to farmers or miners, liberal terms are required, as illustrated by the relative ease with which agricultural machinery can be purchased by the soil tiller. On the other hand, merchants dealing with city trade are more likely to sell on shorter terms and to be more exacting in making collections and in general credit requirements.

Attitude of Credit Manager.—Within certain broad limitations, as determined by the policy of the house, credit managers are given a great deal of latitude in the exercise of their power as credit dispensers. Accordingly, some lay greatest stress on a customer's financial responsibility, others judge the risk primarily by character, while still others maintain that capacity as manifested by one's ability to manage his business properly is the prime essential. Again, some credit managers follow a more or less rigid policy of keeping down losses from bad debts to a minimum, losing sight of the real perspective of credit work, which calls for a minimum of losses consistent with a maximum of sales. On the other hand, many credit managers grant credit too freely, accept too many large hazards, roll up excessive losses, and generally demoralize the entire credit system. The purpose of most houses, however, is to steer a middle course and avoid a too free or a too exacting policy.

It should be noted at this point that the difference of opinion among credit grantors as to the relative strength of the three C's is determined by one or two things. The commonest basis is a credit manager's personal experience. When he insists upon the presence of financial responsibility, it is likely that in the past he has probably suffered greatest loss because of the lack of that element. On the other hand, another man whose house has found

it most advantageous to insist upon moral responsibility as a basis for a line of credit would naturally assign character the greatest value.

Another basis used as a guide by credit managers consists in statistical data relating to failures. If it is known that the largest percentage of failures within a given period is due to fraud and the next largest to incompetency, it is natural that character should be considered of prime importance, capacity assigned second place, and capital third.

The Business Cycle.—As pointed out in the first chapter, business is dynamic and not static. The oscillating movement of business from prosperity, to crisis, to depression, to revival, to prosperity, and over again, has been clearly and conclusively demonstrated by the experience of nearly a century in the United States and abroad. A credit executive must, therefore, constantly keep his hand on the pulse of general business conditions and movements and sense changes in direction clearly and unmistakably. In a period of rising prices, men with little or no ability may succeed in business, whereas under adverse conditions they are unable to cope with competitive forces. During a period of falling prices and general deflation not only is capital rapidly dissipated, but even character not infrequently undergoes abrupt changes. Many an honest person is forced by circumstances to resort to measures not approved of by moralists.

Because of the foregoing, it can readily be appreciated that, to succeed, the credit manager must project into the future and imaginatively foresee changes in economic conditions in their bearing upon his risks. Since all time transactions involve the future, and payments for goods are deferred, it is essential that in seeking and in analyzing credit information all elements be sought which not only have a bearing upon the present status of the customer, but also upon the more or less immediate future. In other words, the information obtained must be construed not only in the light of prevailing business conditions, but also with respect to the future.

SELECTED REFERENCES

Ettinger, R. P., and Golieb, D. E.: "Credits and Collections," chap. 6.
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PART II

SOURCES OF CREDIT INFORMATION

CHAPTER VIII

MERCANTILE AGENCIES

Definition and Types of Mercantile Agencies.—It would hardly appear unsafe to state that in many houses by far the largest percentage of orders on credit is passed upon principally or entirely on the basis of information secured from mercantile agencies through their reference or rating books, special reports, or both. Mercantile agencies are institutions formed for the sole purpose of gathering information concerning the credit standing of merchants, manufacturers, and traders generally, and disseminating that information to their respective members or subscribers.

These agencies are of two types, general and special. The former are very large organizations, cover many and varied lines of trade over an extensive area, and are universally used and recognized as authoritative and valuable. The two leading institutions of this type are the R. G. Dun & Company, and the Bradstreet Company, better known as Dun's and Bradstreet's. Special agencies restrict their operations either territorially or according to lines of trade and types of names investigated. They generally cultivate the field more intensively and furnish information of a more thorough and specialized nature, as will be shown in the latter part of the present chapter.

GENERAL MERCANTILE AGENCIES

Origin.—The mercantile agency system was an immediate outgrowth of the crisis which occurred in 1837. Prior to that date, western and southern merchants visited their sources of supply in the eastern market once or twice a year. Credit relations were then established through personal contact and through recommendations of old customers in good standing.

In those earlier days there was but little definite information accessible to the merchant concerning his customers' character, capacity, and financial strength, and confidence was, therefore, not infrequently badly misplaced. The means of travel were

slow, uncertain, and difficult, and the traveling salesman had not yet made his appearance. Communication facilities were equally inferior and inadequate, so that but meager data, of an uncertain nature, could be obtained through mail inquiries. As a result, credit was injudiciously dispensed and during times of stress the losses incident thereto were appalling. To be sure, a few of the larger houses employed agents whose duty it was primarily to collect accounts and incidentally to gather all sorts of data pertaining to the customers' credit standing. The vast group of smaller houses, however, found this method prohibitive from the standpoint of cost and were forced to base their credit decisions upon the meager and uncertain information made available principally through the personal interview.

The avalanchial movement which finally swept the country as a result of the crisis of 1837 carried with it destruction and ruin to numerous banking institutions and business houses, the effect of which was felt the more keenly and painfully in the market of the East. With the passing of the clouds, merchants throughout the country began to realize that one of the chief contributory causes of the crash and the depression which followed was inherent in the conditions which governed credit granting in this country. Verily, no other factor was responsible to any greater extent for the extensive speculation and overtrading which prevailed in the West prior to the panic than the assumption of unnecessary hazards involved in the unsystematic and unscientific credit extensions. Thus the crisis of 1837 brought the merchants face to face with the necessity of closer and more thorough scrutiny of credit risks. The eagerness with which information was sought for by sellers of goods on time finally resulted in the establishment of the mercantile agency.

History of Dun's and Bradstreet's.—The first general mercantile agency was established June, 1841, by Lewis Tappan, a New York merchant, who carefully recorded all the information he could gather having a bearing on his customers' standing. The records thus compiled covered a series of years and embodied the concern's entire experience with all firms trading with the house. The jobbing house of Lewis Tappan failed, but the records were preserved. The eagerness with which other houses sought for this information encouraged him thus to establish the first organization for the sole purpose of collecting and disseminating credit information.

In 1845 Benjamin Douglas joined Lewis Tappan and his brother Arthur, who was associated with him, and in the year following Douglas was admitted as a partner, and assumed the chief management of the business. In 1849 Lewis Tappan retired, his brother taking his place, and the firm style was changed to Tappan and Douglas. In 1854 Benjamin Douglas became sole proprietor and at this time his brother-in-law, Robert Graham Dun, was admitted into partnership, the firm being succeeded by B. Douglas and Company. Douglas finally withdrew in 1859, selling his interests to his partner, and the company was thus succeeded by R. G. Dun & Company, the present proprietors.

The Bradstreet Company was organized in 1849. In the year preceding the formation of the company, John M. Bradstreet, a Cincinnati attorney, was made assignee of a large insolvent estate. While thus performing his duties, he necessarily acquired a great deal of information concerning debtors and creditors of the estate, residing in and near Cincinnati. He, thereupon, proceeded to make arrangements with several New York concerns for the selling of the credit information thus accumulated. The venture proving a success, he was led to found an institution similar to that described in the previous paragraph for the exclusive purpose of dealing in credit data. Bradstreet's Improved Commercial Agency was consequently inaugurated in 1849 and the firm was finally incorporated in 1876 under the present name.

Numerous other agencies entered the field of furnishing similar services, but were compelled to abandon the undertaking and retire, so that these two organizations now have practically a monopoly of the general agency business operations. It is not likely that any competition will develop in this field of activity in the immediate future, for it is doubtful if any new institution commencing now could immediately or within a short space of time so perfect its organization as to be able to furnish the same kind of service on as vast a scale as the two agencies are at present rendering. This fact tends to enhance considerably the reputation for reliability, permanency, and superiority that these agencies now enjoy and have enjoyed for many years past. These older agencies not only have the undisputed advantage of an early start, but are also a product of a long series of years of gradual expansion and invaluable experience.

Extent of Agency Operations.—At the inception of the first mercantile agency in 1841, it consisted of one office located in New York and comprising one room and six clerks. At the present writing the organization has 263 branches, 79 of which are located in important trade centers outside the United States. Similarly, the Bradstreet Company has at present as many as 216 branches. Of these, only 33 are located in cities outside the United States. From these figures it appears that the strength of the two competitors in their domestic operations is about equally matched, as far as the number of offices is concerned, with 184 branches of Dun's against 183 of Bradstreet's.

In addition to branches, the agencies have business connections with mercantile agencies in Germany, Austria, and other countries, through which credit information may be gathered and cleared. Thus, the entire country is served by their branch offices, and their numerous representatives and correspondents are to be found everywhere busily engaged in investigating local merchants and new enterprises. In order to assist in foreign trade, they have extended their sphere of influence until they have covered the whole civilized world, through their own branch offices or through connections established with similar organizations in foreign lands, as will be shown more clearly in a later chapter.

Obstacles Encountered.—Many difficulties were first experienced by the agencies. Retailers looked upon their activities with suspicion, not wishing anyone to pry into their personal and business affairs. Many jobbers and manufacturers were equally opposed to them because of the inquisitorial nature of their work. Again, agencies feared legal obstacles until the courts declared that communications rendered to subscribers in good faith and without malice and upon request come under the law of qualified privilege. This obviously exempts mercantile agencies from the general law relative to the publication of libelous matter.

Notwithstanding these difficulties and handicaps, the agencies grew and succeeded until the prejudice was gradually overcome, primarily because of the business conditions which prevailed in the early days of their development. With the westward movement then taking place, merchants began to appear in newly settled parts of the country and business relations necessarily extended over a much larger geographic area. Many firms at

this time had but a transient and temporary existence; others migrated from place to place, constantly experimenting with new conditions and opportunities. The rate of mortality among dealers was abnormally high, business connections rather loose, and speculation rampant.

All of the unsettled conditions just described were many times accentuated by the effects of the Civil War. Under such circumstances, it was not especially difficult for the agencies to justify their methods of doing business.

The publication of the standing of business men by the agencies widened the market for retailers who heretofore, because of lack of contact with distant markets, were compelled to confine their dealings to the jobbers and manufacturers of the immediate vicinity. Manufacturers and jobbers, on the other hand, discovered that, by properly cooperating with these institutions, credit information of a more reliable character could be secured more economically than through their own corps of investigators. For these reasons merchants at first involuntarily, and later more willingly, submitted their information, thereby paving the way to success for both of the mercantile agencies.

Organization and Operation of General Agencies

General Scheme of Organization.—Both Dun's and Bradstreet's are organized under the supervision and control of their respective executive or central offices in New York. The country is divided into districts, each identified by a number. A district generally covers one or more counties. The Columbus Branch of the R. G. Dun & Company, for example, operates over as many as 19 counties. In each of these districts there is a central office under the immediate control of the district manager. These offices are self-supporting and constitute central points at which district credit information is conveniently assembled and transmitted to the proper offices and subscribers. Each of the districts may also operate one or more suboffices, depending upon the size of the territory assigned and the amount of business done by the district in question.

Two clearing houses are maintained by R. G. Dun & Company, one in New York, and the other in Chicago. The function of these offices is to conduct investigations along certain definite and specialized lines and to clear information con-

cerning names in those trades for all of the branches. Among the special lines thus handled are department stores, wholesale grocers, women's ready-to-wear, and men's clothing. It is interesting to note that most of these trades are concentrated in no small degree in the two cities in which the special offices are located.

Classes of Investigators.—The agencies employ the following classes of reporters and investigators:

1. Local reporters and correspondents
2. Traveling reporters
3. Special correspondents in county recorders' offices
4. General reporters.

1. *Local Reporters and Correspondents.*—These are charged with the task of investigating all the lines of trade and names located in the community or district to which assigned. These reporters and correspondents cover the same territory year after year, thereby gaining the advantage of close acquaintance with local trade conditions and individual businesses therein. Two or more correspondents are frequently employed by the agency for the purpose of reporting on the same trade in a given community. Upon receipt of a request for a special report, assuming that information on file in the office of the agency is lacking, two or more local reporters may be asked to make the investigation, each one unconscious of the fact that the work is being duplicated. A comparison of these reports will reveal any discrepancies which might occur and serve as an effective check on the efficiency with which the functions of the correspondents are discharged.

Local correspondents, who in many instances are attorneys, devoting only a portion of their time to the work of reporting, are also utilized for the purpose of checking up as to the correctness of names, firm styles, nature of the business, whether wholesale or wholesale and retail, etc. They are also required to record on the proper form (see Fig. 16) any material changes in the credit responsibility of the names listed on the face of the form provided for the purpose, such as the retirement or addition of partners, and the like. The names submitted for checking appear on the left side of the form; on the right side corresponding numbers and columns are reserved for corrections, if any are to be made.

79

SENT OUT..... No..... RECEIVED.....

THE BRADSTREET COMPANY.

INCORPORATED

ESTIMATED WEALTH.			GRADES OF CREDIT.			
G	$1,000,000 and above.					
H	500,000 to	$1,000,000	Aa	A	B	
J	400,000 to	500,000				
K	300,000 to	400,000				
L	250,000 to	300,000	A	B	C	
M	200,000 to	250,000				
N	150,000 to	200,000				
O	100,000 to	150,000				
P	75,000 to	100,000				
Q	50,000 to	75,000	B	C	D	
R	35,000 to	50,000				
S	20,000 to	35,000				
T	10,000 to	20,000	C	D	E	
U	5,000 to	10,000				
V	3,000 to	5,000				
W	2,000 to	3,000	D	E	F	
X	1,000 to	2,000				
Y	500 to	1,000				
Z	— to	500	E	F		

The division sign (÷) indicates that the responsibility and credit of the subject is divided between two or more businesses.

☞ PLEASE READ THIS CAREFULLY. ☜

(STRICTLY CONFIDENTIAL.) 19

DEAR SIR:

We submit herewith the names of the business firms of your place as they appear at the present time on our books, AND SHALL BE PLEASED IF YOU WILL FILL THE RESPECTIVE COLUMNS OF THIS BLANK plainly, but concisely, and also, see:

1ST.—If the names are properly spelled and firm styles correctly given.

2D.—Examine if the business is fully and correctly stated, distinguishing the wholesale dealers by the capital initial W., and wholesale and retail by W. and R., placed *in front of the business.*

3D.—If any have sold out, failed, dissolved, or any material change taken place in responsibility (as by retiring or addition of partners), *please note the same, referring to the corresponding number, and give full particulars.* Indicate date of change as near as possible.

4TH.—ADD THE NAMES OF ANY AND ALL DEALERS NOT QUOTED ON THE PRINTED LIST, AND GIVE US FULL PARTICULARS OF THE SAME, *regarding capital, means, character, etc.* (on the reverse of this sheet).

5TH.—If you erase any names, please be particular to give the reason for doing so in *every case,* and the date, as closely as you can, when the business was discontinued.

6TH.—Such names, ratings, etc., as you find correct, please check thus √ in each case.

Please return, in the inclosed stamped envelope, the corrected list as soon as convenient.

Respectfully Yours,

HENRY E. DUNN, PRESIDENT.

NAME AS AT PRESENT QUOTED.		ESTIMATED WORTH.	GRADE OF CREDIT.	RECITE AS TO RESPONSIBILITY, CHARACTER, REPUTATION, BUSINESS ABILITY, PROSPECTS OF SUCCESS, ETC.
		Write information in these spaces against numbers corresponding with those opposite printed names		

FIG. 16.—Report by local correspondent.

On the reverse side of this form the local correspondents are asked to add names of dealers in their district not already quoted in the printed list submitted, citing all the particulars relating to their credit standing, including age, marital status, kind of business, antecedents, estimated net worth and of what composed, and other details in regard to their character, business ability, and the like (see Fig. 17).

In large cities reporters are usually assigned definite lines of trade, so as to enable them in time to become experts along their respective lines and thereby inspire confidence in the business men they call upon for more or less confidential information. The reporters are required to serve an apprenticeship in the office, and must be experienced, keen, and conscientious.

2. *Traveling Reporters.*—Traveling reporters visit every locality several times a year, each covering his particular territory. Merchants are called upon, financial statements secured, and references obtained and verified. Traveling representatives are often called upon to submit reports for the purpose of comparison with those obtained through the local correspondents, as a test of the effectiveness of the latter's work. Traveling reporters are required by the Dun agency to check at least twice per annum on the trade opinions, and to make a complete inquiry as to all points bearing upon the credit standing of each name a similar number of times. In spite of all care exercised in gathering information for the substance of the reports, errors frequently creep in, and it is therefore advisable to supplement the data thus secured with information obtainable from other sources wherever possible.

3. *Special Correspondents in County Recorders' Offices.*—Some person is generally employed in every county recorder's office whose duty it is to keep the agency informed of all deeds, suits, mortgages, and similar instruments filed, which are likely to affect anyone engaged in business, by sending in daily memoranda to that effect. These correspondents are usually clerks regularly employed in these offices, who for an extra compensation render the aforementioned services to the agency.

4. *General Reporters.*—General reporters are agency representatives circulating among business men, particularly in the financial districts, with a view toward securing information concerning general business conditions, trends and movements,

4-6 '23 5cm

NAMES NOT REPORTED ON REVERSE SIDE

☞ Enter name and report of every dealer, however small, whose name does not appear on the printed list on the reverse of this sheet.

NAME (OR STYLE OF FIRM) IN FULL. Give FULL CHRISTIAN and SURNAMES.	AGE.	MARRIED OR SINGLE.	BUSINESS.	COMMENCED BUSINESS WHEN.	SUCCEEDING WHOM	WHERE PREVIOUSLY LOCATED.	ESTIMATED NET WORTH.	OF WHAT COMPOSED. (GIVE DETAILS.)	RECITE AS TO CHARACTER, RESPONSIBILITY, HABITS, BUSINESS QUALIFICATIONS, PROSPECTS AND IF EVER SUFFERED FROM FIRE.
Firm Name							$		
Partners' Names									
Firm Name									
Partners' Names									
Firm Name									
Partners' Names									
Firm Name									
Partners' Names									

FIG. 17.—Reverse side of report by local correspondent.

and searching principally for material for the magazines published by the agency.

Functions of General Agencies

Commercial Rating Books.—One of the two principal functions of general mercantile agencies is to publish rating or reference books. These are rightly regarded by the profession as credit encyclopedias. Rating books are issued quarterly in several volumes or divisions. One agency, for example, publishes nine different books according to the following schedule:

No. 1. United States and Canada.
No. 2. United States.
No. 3. Western and Southern States, including Alaska, Hawaii, and parts of Canada.
No. 4. Western States, including Alaska and parts of Canada.
No. 5. Southern States.
No. 6. Publication discontinued.
No. 7. Pacific Coast, including Alaska, Hawaii, British Columbia, and the Yukon region.
No. 8. New York, New England, and Canada.
No. 9. New England and Canada.
No. 10. Canada.

These books contain ratings of merchants, manufacturers, and traders generally, and are arranged alphabetically by states, cities, and counties, with the names of the merchants in each community arranged alphabetically under each locality. The books are loaned and not sold to subscribers, with the provision that no one outside the subscriber and his employees is entitled to use them.

Pocket editions of any of the states included in the volumes loaned to subscribers are published by the agencies for the convenience of subscribers or their representatives. These editions may be secured only by regular subscribers for an extra charge as per schedule of prices published by the agencies.

Contents of Rating Books.—In addition to the ratings of the various names appearing on the books under the proper geographic units, rating books also give the population of each town and show whether or not it is a banking community, and, if not, the nearest town in which a bank or banker is located is designated by an appropriate mark or symbol. Trades are

classified and alphabetically arranged, Dun's reference books containing as many as 241 different trades. Each trade is designated by a sign, as shown in the accompanying illustration. Decorators, for instance, are designated by an X mark; distillers by □; billiards by □; etc. Such a sign indicating the trade either precedes or immediately follows the name rated. At the end of each state is to be found a fairly complete list of banks and bankers, and also state maps and state collection laws. The appendix usually contains Travelers' Route Maps, and digests of the Negotiable Instruments Law, and the Bankruptcy Act.

Ratings.—Ratings consist of symbols used by the agencies to express their conclusions concerning a merchant's credit standing in a condensed form. They consist of two elements, financial strength and general credit. The first of the two signs employed

KEY TO R. G. DUN & COMPANY'S RATINGS

Estimated pecuniary strength	General credit			
	High	Good	Fair	Limited
AA Over $1,000,000	A1	1	1½	2
A+ Over $750,000	A1	1	1½	2
A $500,000 to $750,000	A1	1	1½	2
B+ 300,000 to 500,000	1	1½	2	2½
B 200,000 to 300,000	1	1½	2	2½
C+ 125,000 to 200,000	1	1½	2	2½
C 75,000 to 125,000	1½	2	2½	3
D+ 50,000 to 75,000	1½	2	2½	3
D 35,000 to 50,000	1½	2	2½	3
E 20,000 to 35,000	2	2½	3	3½
F 10,000 to 20,000	2½	3	3½	4
G 5,000 to 10,000	.....	3	3½	4
H 3,000 to 5,000	.....	3	3½	4
J 2,000 to 3,000	.....	3	3½	4
K 1,000 to 2,000	.....	3	3½	4
L 500 to 1,000	.....	.....	3½	4
M Less than 500	.....	.....	3½	4
Where only a credit rating appears, this line of credit designation applies	1	2	3	4

KEY TO BRADSTREET'S RATINGS

Estimated wealth			Grades of credit		
			1st	2nd	3rd
G	$1,000,000 and above		Aa	A	B
H	500,000 to	$1,000,000			
J	400,000 to	500,000			
K	300,000 to	400,000			
L	250,000 to	300,000	A	B	C
M	200,000 to	250,000			
N	150,000 to	200,000			
O	100,000 to	150,000			
P	75,000 to	100,000	B	C	D
Q	50,000 to	75,000			
R	35,000 to	50,000			
S	20,000 to	35,000			
T	10,000 to	20,000	C	D	E
U	5,000 to	10,000			
V	3,000 to	5,000			
W	2,000 to	3,000	D	E	F
X	1,000 to	2,000			
Y	500 to	1,000	E	F	
Z	0 to	500			

The broken lines which separate the different grades of credit indicate the ratings (on the left) ordinarily required by credit insurance companies before they will indemnify the insured against losses.

in assigning ratings denotes capital resources and reflects the estimated net worth after appropriate deductions and allowances for shrinkage are made. The second sign denotes the grade of credit and is based upon an investigation as to the manner of payment, business ability, personal habits, and similar factors which are likely to affect the future of the enterprise. The ratings used by the agencies are as indicated in the accompanying schedules.

The assumption in assigning ratings is that there exists a close relationship and relative proportion between the capital strength of a business, as evidenced by the amount of its net worth, and its credit standing. Capital for these purposes is thus considered the foundation for credit, which is merely qualified by character and business capacity. Thus, the first grade of credit opposite

the "estimated wealth" column indicates that the elements are in exact proportion, while the third grade under the Bradstreet system or the "limited" grade under Dun's would seem to reflect inferior character or lack of business ability, or both. To illustrate, if it is determined that the estimated wealth of a given concern is approximately $30,000, and the credit grade superior, the rating assigned by the Dun agency would be E2, and by Bradstreet, S-C.

Sometimes one or more of the partners in the firm which is being rated are liable in other firms and credit responsibility is, therefore, divided. To indicate such a division of responsibility and credit of the subject, the division sign (÷) is employed by Bradstreet's and the italic (*d*) in parentheses preceding the rating is used by Dun's.

Agencies sometimes find it difficult to secure adequate information to justify a definite estimate as to the financial responsibility of a subject, but if the subject is recognized in the community as having credit, a rating will be assigned consisting only of the grade of credit. In such instances, the rating represents a credit relative in degree to that reflected by the signs in the first column of the credit ratings. To illustrate, A under the Bradstreet plan would indicate a credit similar to that assigned a subject having estimated wealth at from $150,000 to $500,000; B would represent a credit in the same class relatively as is assigned a subject with wealth estimated at from $35,000 to $150,000, etc.

Utility of Commercial Ratings.—The chief weakness of the commercial reference books lies in the incorrectness of the status which they reflect, except perhaps at the date of issue. Business conditions are rapidly and constantly changing, and ratings are, consequently, subject to considerable revision. It is estimated that changes in names and ratings average over 5,000 each business day, so that notwithstanding the correctness of a rating at date of its publication, it soon becomes less useful and sometimes misleading. Over 850,000 changes were recorded by the Dun agency alone during the first six months of 1923, averaging 5,642 changes each business day. Again, ratings merely express opinions of the editors of the reference books, which may be entirely divergent with those of the credit men using them.

In view of the foregoing, ratings should not be relied upon as the sole basis for reaching credit decisions, unless the orders

under consideration are small and immediate shipment is required. Otherwise, they should be used by credit managers merely as an index, to orient themselves with respect to the risk under advisement and as a check upon other sources of information. Thus, if the rating is distinctly inferior, credit may be at once refused, and if unquestionably favorable, the order may be accepted on that basis alone and a detailed investigation into the debtor's credit and financial responsibility for the purpose of establishing a limit instituted at a later date. On the other hand, if upon consultation of the rating book it is discovered that the risk is doubtful, it is obvious that, to avoid losses, shipment should be somewhat delayed and supplementary information from other sources sought for prior to reaching definite conclusions.

Ratings may also be profitably employed for making periodical revisions of the credit files. A downward change in a rating will always necessitate a new investigation of the trader affected thereby. Rating books are also commonly utilized as an aid in compiling lists of prospective customers for solicitation, thereby preventing the solicitation of inferior accounts which would have to be rejected ultimately and effecting a saving of time on the part of the salesmen, who would otherwise attempt to secure undesirable trade. These books may finally be used as an aid in securing additional data for credit as well as collection needs, for from them the credit manager can ascertain whether or not there is a bank or banker in the community wherein a given risk is located, and, if not, the nearest banking town to which such locality is geographically and financially tributary.

Special Reports.—Another important function of the general agency is to furnish to subscribers upon request special reports on subjects of inquiry. It should be stated in this connection that the agency has no possible motive to injure or misrepresent any merchant, for its only and true interest, for obvious reasons, is to convey as nearly as possible the whole truth in every report. The prosperity of the agency is directly proportional to the extent to which the reports prove beneficial to subscribers. Accordingly, should a report exaggerate the financial and moral responsibility of a trader, subscribers will be apt to trust him in like measure and the agency would be blamed for the losses suffered incident to the reliance upon such report. Should a trader be reported too unfavorably, subscribers, by denying

credit, would be losing a good paying customer, and the institution would be equally blamed. It is to be conceded, therefore, that the entire success of a mercantile agency system depends upon the general truthfulness and complete impartiality of their reports and records.

Special reports should be called for under the following circumstances:

1. When an order is received and it is found that no data is on file and that the rating alone is inadequate as a basis for rendering a credit decision.
2. When a revision of an account is being made.
3. When the last agency report on file is found to be too old and out of date.

Contents of Agency Reports—Points Covered by a Bradstreet Report.—The arrangement and grouping of the information entering into a report varies substantially with the two leading general mercantile agencies. The various points usually covered by special reports issued by Bradstreet's are submitted herewith in the order in which they generally appear:

1. The Composition of the Firm and the Full Firm Style and Address. If a partnership, the names and addresses of the partners are stated; and if a corporation, the names and addresses of the officers and directors are generally included.

2. Financial Condition. This includes a complete and detailed statement of assets, liabilities, and proprietorship, usually obtained directly from the subject, and is intended to represent recent status of the firm's financial responsibility. Attempts are made wherever possible to secure a statement over the trader's signature, but in many instances unsigned statements are still presented. Under such circumstances, however, the fact that the property statement is unsigned is definitely stated in the report.

A summary of the totals of assets and equities of previous statements, if any is in possession of the agency's office, is also included under this heading.

Then follow comments on the correctness of the figures presented in the statements. These comments are made by the employees of the agency and reflect their opinions, which are, of course, no better than the person making the report. Some of the figures nevertheless lend themselves to verification, and this is often done by the agency. Cash in bank, for example,

may be readily and substantially verified. Estimates may be obtained from outside sources, such as independent appraisers, as to the actual and conservative value of properties listed in the statement. In any event, the comments respecting the facts presented in the statements are valuable and should be regarded as such in most cases, for these are frequently based on other information secured by the reporter in the course of his investigation directly or indirectly, and may also reflect a knowledge of the general trend of affairs which every competent editor should possess.

3. Trade Opinions. This section of the report includes a list, too often incomplete and therefore unrepresentative, of opinions of houses dealing with the subject of the inquiry. They indicate the debtor's manner of meeting his obligations to other creditors, whether prompt, slow, very slow, discounts, and the like.

4. Antecedents. This contains a brief history of the concern and its management. It includes a statement as to the inception of the enterprise, whether it started anew or succeeded another firm or firms previously thus engaged. If a corporation, the state in which incorporated is given. Occasionally, a statement in regard to the manner in which the business was acquired is to be found here. This section also includes the age and past records of the proprietors, officers, and directors. The former business connections of all these individuals and the degree of success which marked the performance of their duties in the past, added to their reputation for honesty and integrity, are, as a rule, a fairly accurate barometer of the prospective credit standing of the firms with which they are at present associated.

5. Fire Records. Both agencies have a statement in their reports as to whether or not any fire losses are known to have been suffered by the subject in question, and, if so, the circumstances surrounding the case.

6. General Remarks. This usually contains a statement as to the business ability of the management, the personal reputation of its managers; also comments regarding the location of the business, its accomplishments, and prospects for success. All of this section obviously consists of the reporter's opinions and impressions and should, therefore, be verified and substantiated by the credit manager wherever feasible.

7. Rating Assigned.

Points Covered in a Dun's Report.—Dun's agency follows a somewhat different grouping of the points discussed heretofore and its reports also differ considerably as to the quality and number of trade opinions. This agency's report consists of the following sections:

1. The Heading. It contains the name of the firm in question, address, line of trade, the names of the proprietors, officers, and directors, the date of the report and the channel by which the information was secured, usually by traveling reporters.

2. Records. The section thus entitled includes all the antecedents of the firm and its members or officers; also the age and marital status of the managers and proprietors.

3. Statements. This section comprises two distinct parts, both bearing upon the financial condition of the name investigated. The first part consists of a summary of totals of assets, liabilities, and net worth of previous statements. The more important portion of the section immediately follows and consists of the latest statement in full detail, listing all of the items separately, so that the various ratios may be easily discovered upon analysis by the credit manager to whom the report is submitted.

4. General Information. In this section are contained comments as to the location of the business, condition of the stock on hand, as well as remarks respecting the accuracy of the figures. Any other pertinent facts affecting the character, business ability, and general outlook are cited therein.

5. Trade Reports. In this regard, the Dun agency reports differ widely from Bradstreet's. A little over two years ago the former agency organized and developed in connection with its then existing organization a Trade Report Department. The aim of this department is to secure and render to subscribers a sufficient number of trade opinions of a high order, the freshness and value of which could be clearly and unmistakably demonstrated. This special service has grown to such tremendous proportions that the demands and requests for trade reports, as they are labeled, from subscribers, non-subscribers, and branch offices have increased from 16,328 during the month of November, 1920, to 185,229 for the month of November, 1922, an increase of over 10 times the previous figure.

To accomplish the end sought in regard to the collection and

transmission of trade information, every representative is furnished with a form (see Fig. 18) in which references of the name investigated and secured from different sources are en-

NAME	BUSINESS	TOWN	STATE

PLEASE RESERVE THIS SPACE	HOUSES	STREET ADDRESS	CITY	STATE

FIG. 18.—Form for listing trade references.

tered. Upon receipt of this form at the district office, each reference is given a number in the space reserved for the purpose on the left-hand side of the form and the references are

ESTABLISHED 1841 — 224 BRANCH OFFICES

REFERENCE INQUIRY

R. G. DUN & CO.

Columbus, Ohio.....19..

.....

.....

Dear Sirs:

Information respecting the manner in which merchandise bills are met is a most important item in present-day reporting. In opening new accounts, and extending credit, facts pertaining to method of payment, with other houses selling, are generally required.

In order that we may obtain these facts and correctly reflect your credit standing, kindly outline below the names and addresses of concerns from whom you make your principal purchases, sending same to us at your earliest convenience, and oblige

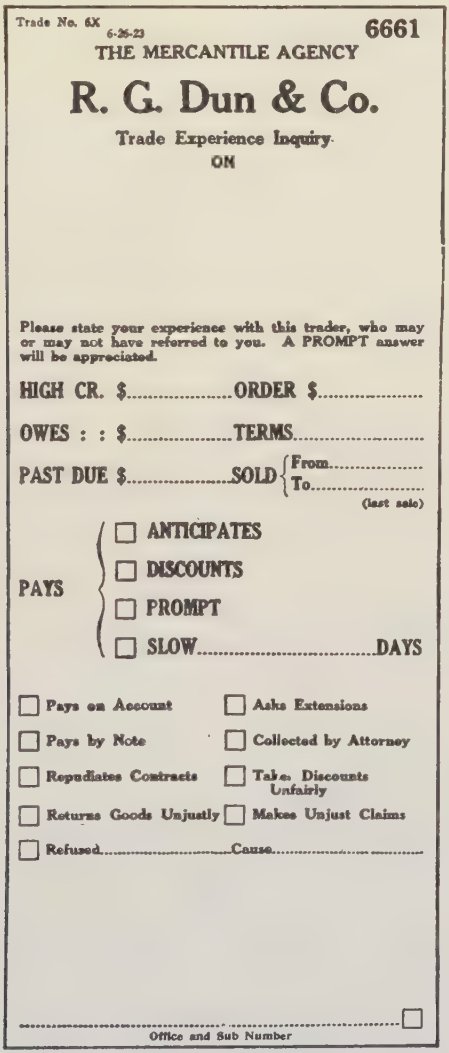
Respectfully yours,
R. G. DUN & CO.
TRADE REPORT DEPT.

PLEASE RESERVE THIS SPACE	HOUSES	STREET ADDRESS	CITY	STATE

FIG. 19.—Reference inquiry.

thereupon investigated. Should the number of references thus secured prove inadequate, a reference inquiry form (see Fig. 19) is immediately forwarded to the firm under investigation, re-

questing a list of references of concerns from whom principal purchases are made.



Trade No. 6X 6-26-23 **6661**

THE MERCANTILE AGENCY

R. G. Dun & Co.

Trade Experience Inquiry

ON

Please state your experience with this trader, who may or may not have referred to you. A PROMPT answer will be appreciated.

HIGH CR. $.....ORDER $.....

OWES : : $.....TERMS.....

PAST DUE $.....SOLD { From..... To..... (last sale)

PAYS
- ☐ ANTICIPATES
- ☐ DISCOUNTS
- ☐ PROMPT
- ☐ SLOW.....DAYS

☐ Pays on Account ☐ Asks Extensions

☐ Pays by Note ☐ Collected by Attorney

☐ Repudiates Contracts ☐ Takes Discounts Unfairly

☐ Returns Goods Unjustly ☐ Makes Unjust Claims

☐ Refused.....Cause.....

.....☐

Office and Sub Number

FIG. 20.—Trade experience inquiry.

From these reference lists separate trade experience inquiry forms (see Fig. 20) are made out and forwarded, one to each reference, requesting a statement of experience with the firm named thereon, stating all the facts relating to the manner of

payment and general repute. In the meantime, the trade reference lists are placed in a pigeonhole marked with the date of the month when the inquiries were sent and remaining there for a period of 15 days, at the end of which all returned trade experience inquiry forms are gathered and compiled as indicated in the accompanying trade reports.

The numbers appearing at the bottom of these reports designate the references of whom inquiries were made. These references may be subscribers, non-subscribers, and other branch offices of the agency. It should be noted that, for the most part, trade reports are furnished apart from the usual special report, but if the information is available at the time a request for a full special report is received, the trade information is furnished therewith.

6. Fire Record.

7. Rating.

Following are specimens of the typical trade reports referred to in a previous paragraph.

DUN'S TRADE REPORT

SMITH, WM. — WALL PAPER & PAINT — HEBRON, OHIO. LICKING COUNTY.

9/18/23

H C	ORDER	OWE	DUE		
550	..	..	..	Discount.	Terms 3-10-90. Sold years to 8-30-23.
674	..	..	..	Discount.	
515	..	..	..	Prompt.	Terms regular. Sold from July, 1923.

Trade (5485-700)-(1888-854)-854-5158

DUN'S TRADE REPORT

JONES, R. C. — GRO. & MEATS — PORTSMOUTH, OHIO. SCIOTO COUNTY.

9/19/23

H C	ORDER	OWE	DUE		
70	..	32	..	Prompt.	Terms 30. Sold from 1920 to 8/18/23.
190	..	65	..	Prompt.	Sold from 1922 to 8/23/23.
60	..	..	..	Prompt.	Sold to August, 1923.
220	..	..	..	Discount.	Sold several yrs. to 8/8/23. Terms 30 days net.
50	50	..		Slow, 60 days.	Terms 2/10 n 30. Sold from 11/19/21 to 5/19/23.
250	50	71	..	Prompt.	Terms weekly.
75	..	35	..	Prompt.	Terms weekly. Sold several years.

Trade 1724-1731-2000-93-3386-13200-174

Typical Agency Reports.—In order clearly to demonstrate the nature and type of reports issued by the general agencies, three actual reports, with the names changed to prevent identification, are submitted for examination. These reports are regarded as typical for the size of the business reported on and were selected chiefly on that account. It should be noted that deviations from the contents as presented in them are many and varied, for it is sometimes difficult to gather any reliable information concerning certain debtors, largely because of the antagonistic attitude of the merchants toward the agency, which, in their opinion, is attempting to pry into their affairs, but more often because of the newness of the enterprises investigated.

ADAMS & SON — DRUGS — CINCINNATI, OHIO.
John L. Adams — HAMILTON COUNTY.
Clarence F. Adams
Cond. 60-6661—June 21, 1923-Trav. Rpt.

Record

Are married, aged about 62 and 30, respectively. Business was established originally in 1882 as Adams Bros., but J. L. Adams subsequently took over same and later admitted a partner, one by the name Miller, but in 1890 he took over the business and later admitted his son, who has only a nominal interest.

Business record apparently clear.

Statements

DATE	ASSETS	LIABILITIES	NET WORTH
Mar. 1914	$13,850	$1,000	$12,850
May 1916	18,040	350	17,690
May 1917	17,800	300	17,500
June 1918	26,000	8,000	18,000

Interviewed June 21, 1923, John L. Adams submitted the following signed statement, figures from estimates.

Assets		
Merchandise on hand at actual cash value	$8,000	
Outstanding accounts at real value	1,000	
Other assets—stocks	4,500	
Total available assets		$13,500
Liabilities		
For merchandise not due, and loans from bank		1,000
Surplus in business		$12,500
Real Estate		
Total value of real estate		18,000
Total worth in and out of business		$30,500

Insurance—on merchandise (partial)—buildings covered.

(*Signed*) John L. Adams & Son
By John L. Adams

General Information

The real estate is the brick business property in occupancy—a three-story affair, centrally located—at $8,000, also a residence in the name John L. Adams at $10,000.

The item of other assets is stock in the General Manufacturing Co., at $3,500, in which John L. Adams is a director, also dividend-paying stock, including Pennsylvania R. R. stock at $1,000.

J. L. Adams is found assessed for taxation at $8,210 for real estate and returns personal chattels at $3,200.

The store presents a neat appearance, stock well arranged, and those at interest well regarded personally, considered capable.

Trade Reports (6/25/23)

H C	Order	Owe	Due	
. .				Discounts.
. .				Discounts.
300		200		Discounts. Sold years to 6/23.

Fire Record None.

G 3 to F 2½

MELDRUM DECORATING COMPANY (NOT INC.) INDIANAPOLIS, IND.
Chas. Meldrum, Propr., 230 E. Main St.,
Cond. 30-3331—September 6, 1923-Trav. Rpt.

Record

Chas. Meldrum is about 45 years of age and married. Claims to have been in business here since 1905. In times past another brother, Robert E. Meldrum, is reported to have been part owner.

Statements

Date	Assets	Liabilities	Net Worth
June 1911	$ 7,900	$2,000.00	$ 5,900.00
Oct. 1914	8,964	280.00	8,684.00
Jan. 1916	9,400	947.85	8,452.15
June 1918	12,600	2,000.00	10,600.00
May 1919	39,050	3,400.00	35,650.00

Interviewed September 6, 1923. Charles Meldrum submitted the following signed statement, as owner of the above business, figures from estimates.

Assets

Merchandise on hand at actual cash value	$15,000	
Outstanding accounts at real value	4,000	
Cash on hand and in bank	1,000	
Machinery, furniture and fixtures	1,000	
Total assets		$21,000

Liabilities

For merchandise not due, open account	1,500
Surplus in business	$19,500

Insurance on merchandise, $6,000

(*Signed*) Chas. Meldrum

General Information

He handles a line of wall paper, paints, kodaks, and camera supplies. Has a large stock, store well equipped, centrally located, and apparently catering to a good-sized volume of trade which is given close attention.

Is well regarded personally, considered capable, and business prospects reasonably good.

Trade Reports (9/5/23)

H C	Order	Owe	Due	
1100		465	450	Slow 30 to 60 days. Terms 30 days. Sold several years. Pays by note.
226		172		Prompt. Terms 30 days net. Sold 2/8/09 to 8/22/23.
702		374	374	Prompt. Terms regular. Sold 11/8/22 to 5/29/23.

Fire Record None

K 3½ to H 3½

1922-400-800
1923-9800

154-9-26-23—Prim.

CENTRAL (THE) MANUFACTURING COMPANY — COLUMBUS, OHIO

A. B. Jones, Pres.
C. D. Brown, Vice-pres., Johnstown, Pa.
J. L. Smith, Sect., Marion, Ohio
D. F. Roberts, Treas., Erie, Pa.

Plants: Ashland, Barberton, and Alliance, Ohio, Bethlehem and Lebanon, Pa.

Directors.—Are the above with K. L. Munson, Delaware, Ohio, C. M. Johnson and T. D. Rutherford of Cleveland, Ohio.

Financial Condition.—When our reporter called at their place of business January 3, January 5 and 6, 1923, Mr. Jones, President, was reported out of the city. They were unable to state when they expected him to return. When interviewed November 14, 1922, A. B. Jones, President and Manager, gave our reporter the following typewritten but unsigned statement and stated verbally that the following statement would be approximately the same given after consolidation was completed. Statement referred to is as follows:

Assets

Current		
Cash	$ 1,955.00	
Accounts Receivable	88,716.69	
Bills Receivable	2,746.00	
Inventories	101,143.21	
Total Current		$ 194,560.90
Prepaid and Deferred Assets		55,825.12
Capital Assets:		
Land and Plant Equipment less Depreciation and Depletion		2,520,501.70
Furniture and Fixtures		4,100.67
		$2,774,988.39

Liabilities

Current		
Accounts Payable	$ 40,235.15	
Bills Payable	58,326.19	
Total Current Liabilities		$ 98,561.34
Bonds		158,000.00
Long-time Notes		46,000.00
Capital Stock		
Preferred Stock	$1,220,651.35	
Common Stock	1,038,253.05	
	$2,258,904.40	
Surplus	213,512.65	2,472,417.05
		$2,774,988.39

Some values given in the above statement are believed to be due to some shrinkages. Cash in bank has been substantially verified. Accounts and Bills Receivable thought to be due some shrinkage. Merchandise is thought to inventory at the above given figure. Land, plant, equipment are also thought to be due some shrinkage. According to statement, the Central Manufacturing Company, Ohio corporation, showed land, buildings, machinery, equipment $1,350,670.16. The Eastern Manufacturing Company, which was consolidated with the Central Manufacturing Company in their statement of June, 1921, claiming real estate assessed at $966,530, other real estate $12,000, tram road $60,576, sidings $13,384, machinery $52,313.42. A. B. Jones stated verbally that the two plants of the Eastern Manufacturing Company, one located at Bethlehem and the other at Lebanon, Pa., were appraised by the National Appraisal Company at $535,000. Clay deposits at Bethlehem were appraised by E. S. Moore of the State College of Pennsylvania at a value of $870,000. The company has no such deposits at Lebanon. Authorities estimate the company's plant at Lebanon to be worth $100,000; however, same is said to be in need of repair. The plant at Bethlehem is reported to have cost the Eastern Manufacturing Company in the neighborhood of $250,000. The company also has Flint and Clay deposits at Ashland; Fire Clay, Plaster, Shale Deposits, and Brick Plant at Barberton; also a Brick Plant at Ashland, and a small coal mine. We are unable to find reliable authorities who would place a definite value on the company's holdings shown above. The company has an authorized capital stock of $10,000,000, of which $4,000,000 is preferred and the balance common. Thought to be a true statement of the company's indebtedness and, while the company is thought to represent some financial responsibility, we are unable to find anyone willing to advance a definite estimate of same.

Trade Opinions.—Too recently engaged in business subject to be established as yet among the trade. The Central Manufacturing Company, Ohio corporation, was reported taking care of obligations in a prompt manner. The Eastern Manufacturing Company was reported as being somewhat slow in caring for obligations.

Antecedents.—This company was organized February, 1923, succeeding the Central Manufacturing Company, an Ohio incorporation, which was chartered

March, 1919, when they succeeded the National Lime Stone and the Barberton Flask Brick Companies, the latter being purchased from creditors. At that time headquarters were located at Ashland, Ohio. In the latter part of December, 1921, headquarters were moved to Columbus, Ohio, and operated same as an Ohio corporation until February, 1923, when charter was dissolved and the Central Manufacturing Company, Ohio corporation, and the Eastern Manufacturing Company with headquarters in Lebanon, Pa., were consolidated. The Eastern Manufacturing Company, a Pennsylvania corporation, was chartered June, 1919, with a capital stock of $10,000,000.

A. B. Jones, President and Manager, was originally a resident of Columbus, Ohio, and was one of the originators of the General Manufacturing Company, Columbus, Ohio, a number of years ago. He at one time appeared as manager. However, he was only interested in that company for a short time. He later moved to Ashland, Ohio, where he was Vice-president and General Manager of a brick and stone company for several years.

C. D. Brown, Vice-president, is a resident of Johnstown, Pa., where he is engaged in general merchandising under his own name. C. D. Brown is also a partner with M. N. and K. R. Doe in Stevens & Company, wholesale grocers, Bethlehem, Pa. Also said to be president of four coal companies, and to own considerable mining property. Reported to be majority stockholder in the above-mentioned coal companies. He is conceded a net worth individually of $275,000.

J. L. Smith, Secretary, also appears as Secretary and Treasurer of the Eastern Manufacturing Company.

D. F. Roberts, Treasurer, is a resident of Marion, Ohio, and has been interested in the company for the past few years, and is also Secretary of the State Securities Company of Marion, having been interested in that company for several years and has resided in Alliance for a number of years.

Mr. Munson is a local attorney and has been engaged in the practice of law in this city for a number of years.

C. M. Johnson is a resident of Cleveland, Ohio, where he is engaged in the life insurance business on his own account and has been so engaged for a number of years. He has resided in this city for many years and is also president of the State Securities Company of that city, which is an Ohio corporation, being chartered March, 1920, succeeding State Securities Company, which had only a small capital stock, and at one time it is understood there were three companies by the same name, being organized by the same parties. That company has a paid in capital stock of $500,200. The company's principal business is said to consist of selling stock at this time in the Standard Phonograph Company, the Central Manufacturing Company, and the John Hollender Company. He is also President of the Standard Phonograph Company, Cleveland, Ohio, which company was chartered under Ohio Laws in 1915.

Mr. Johnson has been an officer of the company since same was incorporated. He at one time appeared as President of the Central Manufacturing Company.

Mr. Rutherford, director, is also a resident of Cleveland, Ohio, where he is said to be connected with Mr. Johnson, having been employed by Mr. Johnson in various capacities for a number of years.

Fire Records.—Not known to have ever suffered fire loss.

General Remarks.—Those interested bear good reputations personally, business is said to be under the active management of Mr. Jones, who is reported to have a fair knowledge of same. The company succeeded to a fairly well-established business, and authorities believe have fair prospects for success.

Letters of Introduction.—Every agency furnishes letters of introduction to its subscribers for their own use and that of representatives employed by them exclusively to enable them, when traveling, to make inquiries at any of the issuing agency's branch offices in the states and territories represented by the volumes loaned to the subscriber in question.

Derogatory News.—Upon receipt of an inquiry from a subscriber concerning a given subject, the subscriber's number is immediately placed opposite the name inquired about and for a period of approximately three years, provided, of course, the subscription is annually renewed, the agency voluntarily advises the inquiring party of any material changes of a derogatory character. These include lawsuits, assignments, foreclosures, bankruptcy, mortgages, irregular transfers of property, and other information which tends to detract from, lessen, or in any way impair the credit standing of the risk. Similar memoranda are also forwarded without request to all branches of the agency which are interested in the name thus affected, as evidenced by previous inquiries received concerning the subject. When an inquiry is received from a branch office, the number by which the inquiring branch is designated is at once placed on the record bearing the name of the party inquired about, and the same procedure is followed as outlined with respect to subscribers.

Business Publications.—A fifth service rendered by the agencies is through their publication of weekly reviews of trade and financial conditions and similar market data. All sections of the country are covered in these magazines, and with agents strategically located at many points the information assembled is usually reliable and worth while. Credit men throughout the country generally recognize that these trade reviews furnish authoritative opinions and aid indirectly in gaging current credit and other business conditions. Thus, the Dun agency, for example, commenced to publish *Dun's Review* as far back as 1893, to which were added *Dun's International Review* since 1903, printed in four languages, and the *World's Market,* which made its appearance in 1917.

Cost of Agency Service.—The cost of securing information from general mercantile agencies varies directly with the extent of service required by the contract entered into by the subscriber. Although rating books are published quarterly, many houses are satisfied with only two half-yearly books, whereas others consider all four indispensable. Again, some concerns prefer more special reports than others, the cost naturally varying proportionally with the number of special reports required. Then, too, the size of territory covered by the books loaned to the subscriber has a direct bearing upon the charge made. In each instance, however, the contract calls for a specific number of rating books and special reports. Thus, the cost of the four rating books covering the Middle Western and Southern states, in addition to 100 reports, approximates $275, while the charge made for only two books and as many as 300 reports amounts to about $250. It should be noted at this point that the charges made for this service vary somewhat with the agencies. Additional special reports will be furnished at a rate of from 75 cents to $1 each. For pocket editions, extra charges are made in accordance with a definite schedule published by the agencies.

Criticisms of General Commercial Agency Service

Lack of Promptness in Reporting.—Probably the most unsatisfactory feature of the existing agency service is the delay involved in rendering reports. It is charged that in case of many first orders or new accounts, or orders requiring immediate shipment, credit decisions must be made on the basis of information secured from other sources, because of the extraordinary delay involved in furnishing special reports by the general agencies.

This criticism is only partially true. Agencies are aiming to anticipate inquiries and to have reports concerning debtors in their files. Credit managers, however, continually demand data reflecting newly created conditions. In such instances, as well as in those cases where information is totally lacking, investigations must be conducted at the expense of promptness in returns. Again, much depends upon the nature of information required and the difficulty of obtaining it. Should the agency possess all the necessary data on file, a report can obviously be furnished on the same day that it is requested. On the other hand, if the data must be procured from widely

scattered sources, more time is necessarily consumed in the process. Furthermore, it is claimed that of the inquiries received, fully 90 per cent are answered immediately, meaning thereby on the date of receipt of the inquiries.

Failure to Revise Reports Frequently.—Too often complaints are registered to the effect that the reports on file are not revised frequently and consequently lack recency and freshness. Several reasons are assigned by critics in explanation of this weakness. One of them is failure to maintain the standard set by the institutions themselves calling for semi-annual revision of the entire data, because of negligence and incompetency. Another cause is the inability of the organizations to keep pace with the constantly increasing number of names reported on. The organizations are too top-heavy and clumsy. The truth of the matter is that too frequent a revision is both expensive and difficult. Agencies derive the larger part of their profit from selling a given report several times instead of each time incurring the expense of collecting new and recent information for the substance of the report. Besides, merchants inquired about would also assume an antagonistic attitude toward the agency and undoubtedly resent too many investigations into their affairs and would ultimately refuse entirely to furnish the required facts.

Failure to Furnish Financial Statements.—Complaint is also current to the effect that agencies fail to obtain financial statements in too many of the cases reported on, and that many of the statements furnished are unsigned. The agencies do not deny this fact entirely, but place the responsibility for the repeated refusal of merchants either to submit statements or to sign them at the door of the credit grantors themselves. Should credit managers themselves require and insist upon financial statements from their debtors, these merchants would in time become educated to the fact that the rendering of statements is good business and justifiable from many viewpoints. As it is, many debtors claim that they are able to secure all the credit without furnishing a statement of their affairs and can see, therefore, no necessity for complying with the request of the agencies to that effect. Agencies are, however, rapidly gaining ground in this connection and to the extent to which this is true, to that extent is the validity of this criticism diminished.

Deficiencies in Trade Opinions.—Several criticisms are advanced on this point. Some claim that the information under this heading is too old to be of any material significance. Other critics attack the agency on the ground that trade opinions are mostly too limited in number and of inferior quality, for they may not cover those references from whom principal purchases are made by the risk. Being limited in number, the list of trade opinions is far from representative and may consist only of those few references with whom satisfactory dealings are maintained solely for the purpose.

In reply to the criticism relative to trade opinions it may be stated that the objections no longer apply to the same degree, at least as far as one of the agencies is concerned. Reference to an earlier part of the present chapter, dealing with the subject, will at once reveal the phenomenal improvements inaugurated by the organization in an attempt to remedy an evil long complained of by subscribers. The degree of success which this additional feature will ultimately achieve remains to be seen. As yet it is still true that this sort of information lacks recency for the simple reason that revisions are instituted only twice per annum. It follows, therefore, that when very recent information is considered essential, other sources of information the chief and perhaps only function of which is to gather and disseminate ledger or trade information, should be resorted to.

SPECIAL MERCANTILE AGENCIES

In addition to the two standard mercantile agencies, there are at present a large number of special agencies of varying magnitude. These are commonly referred to as "special trade agencies," since they generally confine their activities to a single trade or a limited number of allied trades. Most of the large cities have local special reporting agencies covering local names and concerns. Special agencies, though necessarily restricted in their scope, claim to be in a better position to report the trades to which they cater, by reason of their specializing in a few lines and at the same time operating over a limited territory, than are the larger and general agencies which purport to cover all lines of business. On the other hand, it is maintained that the regular agencies, because of their greater prestige and wider contact with general business conditions, secure data that is totally inaccessible to the smaller institutions. If, however, the

success of the special agencies is to be judged at all by their continual existence and enormous growth in both size and number, the form of service rendered by them undoubtedly possesses substantial merit.

Types of Special Agencies.—Special agencies may be classified on the basis of the functions they purport to perform. Some of these organizations restrict their activities solely to the collection and dissemination of ledger information; others purport to duplicate the services rendered by the general commercial agencies, with a special emphasis on trade opinions of a special character peculiar to the trade reported on. The former class of special agency institutions will be treated more exhaustively in the chapter following. Of the latter type, but a few are enumerated here with a view of indicating the nature and extent to which specialization in credit reporting is carried out.

The Furniture Commercial Agency Company maintains several offices in all of the important furniture centers and reports on all names in the trade.

The Bankers' and Manufacturers' Mercantile Agency, with offices in New York City, reports on leather names and on firms issuing commercial paper.

The Drug and Chemical Mercantile Agency, Inc., also located in New York, reports on all names engaged in the drug, chemical, and allied trades.

The Shoe and Leather Mercantile Agency, with headquarters in Boston, reports on tanners, manufacturers, and wholesalers of boots and shoes throughout the country, in addition to other leather names.

Functions of Special Agencies

Reference Books.—Practically all of the special mercantile agencies publish for the use of their respective subscribers rating books, sometimes designated as "Blue Books" or "Red Books." They are published annually, semi-annually, or quarterly, as the case may be, and contain the credit ratings of all names the respective organizations purport to cover. A special feature in regard to these ratings is that they contain frequently three signs or symbols, instead of two, as employed by the general agencies, which is regarded as a much desired improvement. In such instances the signs expressing ratings cover credit standing, capital resources, and paying habits respectively. To aid

in the interpretation of these ratings, a key showing the conditions reflected by the various signs used in the ratings is furnished each subscriber. The third symbol of the rating usually denotes the manner of payment, showing whether the merchant discounts his bills, pays prompt at maturity, or is slow in making settlement. It also covers trade abuses if any, such as the habitual registering of complaints without cause, disregard of terms of sale, deduction of unearned discounts, and practices of a like nature.

Periodic Supplement Sheets.—Supplement sheets bearing changes in ratings are issued periodically to subscribers who may thus keep the rating books corrected until the succeeding revision.

Reports.—Special reports similar to those of the general agencies are issued upon the request of subscribers. Upon receipt of such a request, assuming that no information is available in its files, the agency immediately forwards inquiry forms to subscribers who are thought to possess information respecting the dealer whose standing is under investigation and to other references obtained from various sources. The resulting data are tabulated and a report is prepared and issued. In return for the information furnished, every contributor is entitled to a copy of the completed report.

Emergency reports are also furnished voluntarily and without request to members who are known from previous inquiries to be interested in the subjects covered therein. They purport to warn early the subscribers concerned of the financial weakening of their customers and of impending business disaster, citing all kinds of shady transactions involving suspicious transfers of property, assignments, and the like; and they also contain records of fires, dissolutions, and failures. These reports sometimes assume the form of a bulletin issued daily or weekly to all subscribers.

Collection Departments.—Not unlike the general agencies, these organizations also maintain a department for the purpose of collecting, for a fee, doubtful and past-due accounts for the benefit of subscribers.

Advantages of Special Agencies

Specialization.—By specializing in a single or allied lines of trade, or by operating over a decidedly limited territory,

reporters of these institutions constantly circulate among the same traders and credit managers. They consequently become familiar with all the idiosyncrasies of the merchants and the peculiarities of the trade in which they operate. Their experience along a given line also helps the investigator in determining where a given subject is likely to be known, thereby facilitating him in the location of the sources to be sought for.

Promptness in Reporting.—Lacking the elaborate organization and the wide scope of the general agency, it is maintained that special agencies are prepared to institute immediate investigations concerning the subject of an inquiry, and, being local in character, they are in a position to interview at once local bankers, manufacturers, and jobbers and to ascertain quickly their respective experiences and opinions regarding the subject of their investigation, so that a report may be rendered the same day on which the request is received. Like their competitors, they are aiming to anticipate inquiries by maintaining complete records on file.

Superiority of Reports.—As already referred to in another connection, special agency reports are particularly strong in the number and quality of trade opinions which they furnish. These ledger facts are secured directly from the creditors of the risk and are generally complete both as to contents and number. Another conspicuous feature of these reports is a supplementary record of collection items handled by the agency and complaints registered against the subject.

Complete Ratings.—As a rule, a finer division marks the ratings employed by special agencies, whereby a third symbol, denoting paying habits, etc., is added to the other two which intend to express general credit standing and capital resources, respectively. The object apparently is to overcome an objection raised by many credit managers with regard to the inadequacy and shortcomings of the ratings employed by general agencies, and to avoid generalizations wherever possible.

Weaknesses of Special Agencies.—Chief among the weaknesses of these organizations is the inadequacy of ledger information from the standpoint of variety of references interviewed or otherwise consulted. Operating in a restricted line or territory, obviously, these organizations will likely consult only those creditors who sell within a limited geographic area and whose activities are confined to the special field under consideration.

Thus, many merchants from whom large purchases may be made by the subject of the inquiry are automatically excluded. Again, to assemble all the essential facts reflecting the true status of a customer, extensive and elaborate equipment is frequently required, both of which are lacking in case of the smaller special agencies.

SELECTED REFERENCES

Ettinger, R. P., and Golieb, D. E.: "Credits and Collections," chap. 7.
Hagerty, J. E.: "Mercantile Credit," Pt. I, chap. 8.
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CHAPTER IX

DIRECT INTERCHANGE AMONG CREDIT GRANTORS

Need for Ledger Experience.—Information secured from the mercantile agencies intends primarily to answer the query regarding a customer's ability to pay his bills at maturity. It does not purport to determine satisfactorily his willingness to do so as evidenced by the manner in which his current obligations are actually being met, although substantial progress is to be noted in that direction. It is true, to be sure, that trade information alone is sometimes not a sufficient basis for the extension of credit, for numerous instances can be cited of unreliable merchants, who have deliberately developed a good credit standing by meeting their current obligations promptly and in a satisfactory manner solely for the purpose of ultimately utilizing that preferred credit position for questionable and improper ends. Again, merchants are to be found whose current obligations are discharged with great promptness, but whose antecedents call for extreme care and caution in dealing with them on credit terms, for past questionable practices may be repeated to the detriment of the creditors. On the other hand, unfavorable reports concerning a debtor's paying habits, unless distinctly inferior, should not entirely preclude the establishment of business connections on a credit basis. Unfortunately, there are still many traders whose financial and moral responsibility is proved beyond the shadow of a doubt but whose manner of meeting their bills by reason of carelessness is apparently unsatisfactory. Were a report on trade experience to be followed blindly, much profitable trade would necessarily be diverted to competitors more awake to the possibilities of ultimately developing such merchants into prompt-paying customers.

Notwithstanding all of these limitations and deficiences, trade information is regarded, in the judgment of an ever-growing number of experienced credit managers, as the most valuable basis for credit decisions available to manufacturers and jobbers

selling on time. Most of these merchants are at present participating in some form of system whereby ledger experience is secured. Also, it is widely recognized in the business world that a customer's record of purchases and payments, assuming completeness, is frequently of much more help in intelligently analyzing credit than the combined data of the rating books and agency reports. The degree of freshness and reliability of the information thus secured is one that especially recommends its widespread use and partially accounts for its tremendous development, for it is generally conceded that knowledge of a trader's current activities as reflected in the record of his present purchases and payments is far more valuable than his antecedents or even capital resources.

Significance of Paying Habits.—The extreme value of ledger experience as a basis for a credit manager's judgment in passing upon risks can be demonstrated no better than by showing the effect of paying habits upon a seller's profits. Let us assume, for purpose of illustration, that a jobbing house, whose usual terms of sale are $^2/_{10}$, net 30 days, sells a bill of goods amounting to $1,000 to each of three parties, say X, Y, and Z, respectively. Let us further assume that X discounts the bill, Y pays promptly at the end of 30 days, and Z is 30 days slow. It is obvious that under these circumstances X constitutes the most desirable risk from the standpoint of the jobbing house and Z is the poorest of the group. By comparison of the dates of payment of X and Z, it is not difficult to discover that the seller has the use of the money received from the former 50 days longer than of that secured from the latter. Assuming an average rate of return of 20 per cent per annum on his working capital, the seller will have gained $7.22 ($1,000 less 2 per cent discount plus 20 per cent of $980 = the net amount paid by X for a period of 50 days) by selling to X in preference to Z.

Following the same line of reasoning, it is found much more profitable to prefer non-discounting but prompt-paying customers over those who are chronically slow. This fact may be readily established by a consideration of the profit advantage resulting from selling the bill of goods to Y in preference to Z. Both pay the gross amount of the bill. The seller, however, is afforded the use of the money obtained from Y 30 days longer; thus, when reckoned on a basis of 20 per cent return on his working capital, the seller will have gained $16.65 ($1,000 plus

20 per cent of that sum for a period of 30 days, or one-twelfth of a year).

At this point it might be interesting to compare the profitability of selling to X, who discounts his bills, and to Y, who pays at maturity. In the first instance the seller receives $980 on the tenth day from date of invoice. Using this sum as a part of his working capital for the next 20 days at the rate of 20 per cent per annum nets a return of $10.88 (20 per cent of $980 ÷ 360 × 20). Hence, the total amount realized from the sale to X amounts to $990.88, which, when contrasted with the gross amount received from Y at maturity, shows a deficit of $9.12 on the transaction. It appears, therefore, at least on the surface, that it is more profitable to sell to customers who pay promptly at maturity than to those who discount their bills. A somewhat closer analysis, however, discloses the fact that, notwithstanding the immediate gain that might result from the selection of prompt-pay customers in preference to discounting purchasers, the advantage ultimately vanishes completely and is more than offset by the inevitable losses from bad debts resulting therefrom. Furthermore, the lower the cash discount allowed or the longer the credit period involved in the transaction the greater and more positive the advantage in selecting customers who discount their bills in preference to prompt-paying or "slow"-pay purchasers. Thus, if the discount is lowered to 1 per cent, there would be, in addition to savings derived from keeping down bad debt losses, a positive advantage, due to the greater use of the money, of $1 (20 per cent of $990 ÷ 360 × 20 + 990), as a result of selling to X in preference to Y, and a gain of $17.50 from selling to X instead of Z. The same observation applies in case the credit period is lengthened.

To emphasize further the importance of paying habits, it should be remembered that the risk involved in a credit transaction, other things being equal, varies in direct proportion with the length of time elapsing between the date of shipment and date of payment.

It stands to reason that buyers possessing means will discount their bills if willing to gain a preferred credit position. On the other hand, prompt-paying or slow-pay purchasers probably lack either or both of the elements requisite to a sound credit standing and the hazard incident to extending thus the credit period is correspondingly enhanced.

Securing References.—To ascertain who the creditors of a merchant are, several means are available to the interested party, most of which may be utilized simultaneously with no little profit.

The simplest way is to ask the debtor himself for references, including names of merchandise creditors. The list thus furnished, however, is likely to be limited and of relatively little value, save for the leads which it may contain, for too often, and naturally so, customers select only the names of those whose attitude is highly favorable.

The nature and type of the business in which the debtor is engaged ordinarily suggest types of selling concerns to whom he is probably known. For instance, were a dry goods name being investigated, it would be safe to assume that some of the well-known houses handling knit goods, notions, gloves, hosiery, and underwear would have dealings with the risk. A third and common method is to secure supplementary lists of references through traveling salesmen or traveling credit representatives. Banking houses may quite readily discover the names of concerns selling the subject in question by glancing over canceled checks, if the merchant under investigation is one of the bank's own accounts. Canceled "trade checks" constitute one of the most important sources of securing references and are highly valued by banking institutions.

METHODS OF DIRECT INTERCHANGE

Merchants, manufacturers, and jobbers, to secure the judgment of a trader's creditors as to his business standing, in a way other than through the mercantile agencies, have either associated themselves for the purpose of providing some sort of a system by which ledger experience may be gathered and cleared for the benefit of the members, or have cooperated to this end without the intervention of an intermediary. The former method forms the topic to be discussed in the chapter following. For direct interchange among credit grantors, several ways are open to those seeking information:

1. The inquiring creditor may obtain ledger experience orally:

   (*a*) By personal contact with the creditors in question.
   (*b*) Through the agency of a credit department investigator.
   (*c*) Through trade group meetings.

2. The end of securing ledger information direct from credit grantors may also be attained through correspondence.

Personal Contact.—The simplest yet perhaps the least satisfactory means of credit interchange among creditors is through personal contact of the inquiring party with the credit managers who are known to have had experience with the subject of the inquiry. This method often results in a multiplicity of investigations, especially when the credit risk is undergoing changes the probable effect of which is to weaken his financial condition. Besides, too much valuable time of the occupied credit manager would have to be devoted to the process of calling for or furnishing credit information were this method to be widely adopted.

The Credit Department Investigator.—Practically all banking institutions of substantial size, and many large commercial houses as well, have found it advantageous to use the services of one or more men whose principal duty it is to assist the credit manager in obtaining ledger experiences and opinions of other creditors by going after the information instead of waiting for it to come to them. The office of this investigator may also be used for the purpose of collecting data concerning the status of lines of business in which a special interest is had by his concern. Investigators usually confine their activities to local houses and visit mercantile establishments and banking institutions to whom they think the subject of the inquiry may be known. Banking houses employ credit department investigators also for the purpose of interviewing commercial paper brokers with a view of selecting desirable names and eliminating those which prove to be inferior. In many instances brokers are not used; hence, the most important interview is with banks who have had dealings with the house in question. Information secured from banks is sometimes the only available or reliable supply open to the investigator. These investigators are also employed to a large extent whenever revisions of folders are made.

Method of Operation.—The methods employed by investigators differ considerably and are determined either by suggestion of the credit managers or by the choice of the investigators themselves. Most investigators usually carry with them lists of names they intend to investigate during the day, irrespective of the trade in which the subjects are engaged. Such lists are gone over with the credit manager of each firm visited in order

to ascertain which names are known. Some specialize in checking names engaged in a single line of business. The chief merit of this system consists in the reduction of the number of calls, for, when calling on the trade, inquiry upon several names may be made at one time. On the other hand, credit men often resent the imposition of an investigator in submitting a long list of subjects and are, therefore, not likely to make more than superficial checkings. Still others take one or two names at a time and do not attempt others until the investigations begun are entirely completed.

Information Secured by Investigators.—The points covered in making an investigation vary naturally with the type of creditor interviewed. Should the investigation be conducted in trade circles, the following information is generally sought for:

1. Age of the account. In this connection it should be borne in mind that the longer the account has been on the books, the more valuable the information obtained becomes.
2. The highest credit extended the subject of the inquiry. This denotes the credit manager's opinion of the risk in question.
3. Manner of payment and terms of sale. Knowledge of these facts is an excellent indication of the desirability of the applicant's trade.
4. Current status of the account, representing the state of its activity, amount of indebtedness, and the like.
5. Opinion of the creditor regarding the financial responsibility and personnel responsible for the management of the subject's business. This is of much value, particularly when supported by intimate actual knowledge.
6. Trade abuses, such as cancellation of orders without cause or returning goods upon pretext that defects have been discovered, and all other practices which reflect moral turpitude and general corruption.

As in cases of interviews with merchants, no definite sets of questions should be religiously adhered to in interviewing bankers, for the risks differ so widely as to require varying degrees of knowledge. Nevertheless, a few significant points may be profitably suggested. These are:

1. Age or length of the account.
2. The "line" of credit extended.
3. Highest amount extended.
4. Current indebtedness.

5. Character of balances maintained, for consistently low cash balances usually reflect an impaired cash position and lack of working capital. On the other hand, consistently high cash balances are evidence of inactivity and dullness.

6. The degree to which the subject is dependent on the bank. This knowledge can be gained from a determination of whether or not the concern "cleans up" its borrowings, and for how long. Since commercial banks, as pointed out in an earlier chapter, base their loans on seasonal demands, they naturally expect borrowers to be off their books for at least one or more months during the year. Failure to do so, except during periods of depression, denotes a high degree of dependability on the bank for necessary working capital.

7. General opinion of the management and quality of the account.

Qualifications of a Credit Investigator.—First of all, a person filling such a position should possess a thorough knowledge of the fundamentals, or at least the rudiments, of credit department work. This knowledge is indispensable preparatory to the assumption of the responsibilities in connection with the conduct of investigations. He should have a pleasing personality and must be shrewd and tactful, for the securing of a satisfactory interview depends largely on the personality of the investigator and his manner of approach. During the first interview he is usually received as a representative of his house and is treated accordingly. As soon, however, as he becomes known, he is treated on his own merits and efficiency. Should he appear ignorant or tactless and ask unnecessary questions, his welcome will soon wear out and the interview will probably be a failure.

The qualified investigator is usually well versed in the status of the account before leaving his house on an investigation mission. He will always familiarize himself with the conditions of the name under review from information already on hand, and should never fail to determine definitely what he desires to learn during the interview. It is often quite difficult to obtain the desired data without giving something in return, but the investigator must exercise care and caution in doing this, so as not to circulate rumors and leave the impression that he is spreading gossip. Credit managers are loathe to impart confidential information, which is frequently the most desirable, to an investigator who apparently uses it indiscriminately. Rumor

mongers and tale carriers do not, therefore, make good investigators, for trustworthiness is one of the essential requirements.

Finally, an investigator must be trained to interpret properly the information gained and to grasp quickly the significance of statements made in the course of the interview, thereby avoiding unnecessary questioning. Above all, he should know when the end is attained and cause no unnecessary delays.

Trade Groups.—A highly convenient way for creditors selling in the same market to exchange ledger and other valuable facts is afforded by the meetings to be described presently. These gatherings are usually restricted to members of the respective local credit men's associations, each of which conducts one or more meetings at frequent intervals, usually weekly or semimonthly. Thus, all creditors selling to grocers, bakers, general stores, and allied lines of trade form a provisions division, consisting of wholesale grocers, meat packers, produce dealers, etc. In the larger cities the Credit Men's Association may have organized as many as a dozen or more trade groups, such as women's wear, dry goods, furniture and hardware, printers and stationers, etc.

The purpose of group meetings is to offer a ready means of exchanging information respecting applicants for credit on first orders, slow-pay customers, and all accounts which show abnormal and hitherto unexpected developements. Each of the participants turns in to the group chairman the names of the accounts on which further information is sought, stating the reason for his action. As the name of the inquiry is called off, all those who previously have had experience with the subject voluntarily relate their experiences. In some cases every member receives a number to report by. Where the trade divisions are large, a limit is placed on the number of delinquent accounts or first orders that may be brought up by any one member. It should be noted that not only ledger data enter into the discussion, for an extremely important phase of the work is the exchanging of confidential facts gained through personal contact by some of the participants with the risk in question, involving at times a most intimate knowledge of strictly personal affairs favorable or derogatory. Many other important actions are sometimes taken during these group gatherings. Thus, it is not uncommon there to arrive at a decision jointly to place an account in the

hands of the adjustment bureau, or to throw a debtor into bankruptcy, or to take other measures which require concerted action.

Advantages of Oral Interchange.—Speed in obtaining the desired facts is the principal advantage of this sort of investigation. The value of quick action in passing upon a risk is deeply appreciated by credit managers and needs, therefore, no especial emphasis. A second advantage consists in the freshness of the information thus secured. The consensus of opinions of other creditors constitutes no negligible aid in arriving at a decision respecting a doubtful account.

A third advantage is the superior quality of the information usually obtained through oral investigation. Facts which are communicated sparingly for general circulation are often divulged verbally to the credit manager or his representative. Other information which discretion would forbid appearing on paper may be imparted occasionally in a similar manner. Assuming confidence in the inquiring party, the interview attains the maximum of confidential interchange, the benefits of which, because of the reciprocity commonly practiced, inure to both parties to the interview. Finally, personal contact among credit men tends to foster and encourage cooperation, which is, in a sense, the life blood of credit work. It causes them to appreciate more keenly the hopelessness of individual effort on the one hand and the benefits derived from concerted action on the other.

Objections to Oral Interchange.—Foremost among the disadvantages is the multiplicity of investigations. A widespread adoption of this means of securing credit data would necessarily place a heavy burden on the valuable time of credit managers and cause unnecessary duplication. Again, when many inquiries are made concerning a name, especially when that name is not in a particularly strong financial condition, suspicion of other creditors is likely to be aroused, thereby unduly embarrassing the subject of the inquiries. Then, too, the system lends itself to abuse, inasmuch as investigations may be conducted, not because of an existing interest in the account, but with a view to determining whether or not the subject's trade should be solicited.

Interchange by Correspondence.—Expediency often demands direct interchange of ledger experience among creditors by correspondence. To facilitate and encourage the system

which makes for safe clearance of credit risks, the National Association of Credit Men has approved and adopted a special form, and in addition has drawn up a number of rules for the strict observance on the part of both receiver and giver of credit information.

Kindly give us below YOUR EXPERIENCE with

Name_____ **Business**_____

P. O._____

From whom we have_____**order for $**_____
(Indicate whether first order)

ALL INFORMATION WILL BE CONSIDERED STRICTLY CONFIDENTIAL

Yours truly,

APPROVED AND ADOPTED BY
NATIONAL ASSOCIATION OF CREDIT MEN

To_____

_____

	MANNER OF PAYMENT ANSWER—YES OR NO	
Sold since_____**To**_____		
Terms _____	___	Discounts
Largest amount owing recently . . . . . .$_____	___	Prompt and satisfactory
Total amount now owing, . $_____	___	Slow but collectible
Amount past due, ... $_____	___	Slow and unsatisfactory
Other information_____	___	Days slow
_____	___	Accepts C. O. D.'s promptly
_____	___	Settles by Trade Acceptances
_____	___	Account secured
_____	___	Notes paid at maturity
_____	___	Makes unjust claims
_____	___	Collected by attorney

RETURN THIS TO US.

FIG. 21A.—Form used for direct interchange of ledger experience among credit grantors.

The form used for direct interchange among creditors as recommended by the National Association of Credit Men consists of duplicate sheets containing identical matter, the first sheet being filled out by the maker of the inquiry, containing the ledger

and other experience of the inquiring house. The top and bottom lines of this sheet contain the words "We give you below Our Experience with" and "Retain This For Your Files. Give your experience on attached slip," respectively; whereas the

We give you below OUR EXPERIENCE with

Name_____ **Business**_____

P. O._____

From whom we have_____ **order for $**_____
(Indicate whether first order)

ALL INFORMATION WILL BE CONSIDERED STRICTLY CONFIDENTIAL

Yours truly,

APPROVED AND ADOPTED BY
NATIONAL ASSOCIATION OF CREDIT MEN

To_____

	MANNER OF PAYMENT ANSWER—YES OR NO	
Sold since_____ **To**_____		
Terms		Discounts
Largest amount owing recently . . . . . $		Prompt and satisfactory
Total amount now owing, . $		Slow but collectible
Amount past due, ... $		Slow and unsatisfactory
Other information		Days slow
		Accepts C. O. D.'s promptly
		Settles by Trade Acceptances
		Account secured
		Notes paid at maturity
		Makes unjust claims
		Collected by attorney

RETAIN THIS FOR YOUR FILES **GIVE YOUR EXPERIENCE ON ATTACHED SLIP**

FIG. 21B.—Reverse side of Fig. 21A.

top and bottom lines of the duplicate sheet contain the words "Kindly give us below your experience with," and "Return This to Us," respectively. In all other respects the two sheets are identical (see Fig. 21).

Still further to encourage reciprocity in the exchange of ledger

experience other than through the convenience afforded by the form, and at the same time to prevent abuse of the system, the National Association of Credit Men established the following rules or obligations, most of which are printed on the back of the form used for direct interchange, for the observance of the inquiring department and the department inquired of. These rules may be arranged as follows:

General Rules to be Observed by the Inquiring Department

1. A stamped addressed envelope must accompany the inquiry.
2. Inquiry should be made only when necessary, for indiscriminate and promiscuous use of this system inevitably leads to harm because of the unnecessary labor it involves.
3. The inquirer should be reasonably certain that the credit department inquired of possesses information bearing upon the subject of the inquiry.
4. Inquiries must be limited to orders on hand or to actual ledger accounts. Much complaint against the interchange system is stirred up when inquiries are made with a view to sizing up a prospective customer and determining the desirability of soliciting his trade, unless that fact is plainly set forth at the time the inquiry is made.
5. The inquirer must state accurately the reason for making the inquiry, whether it is made on a first order, a past-due account, and the like, and must state the amount involved.
6. To encourage reciprocity in the interchange of credit experience, it is but fair for the inquiring department to give a complete statement of its previous experience with the subject, unless it be a first order, which fact must be so stated.

Rules to be Observed by the Receiver of an Inquiry

1. All inquiries should be answered as quickly as possible, preferably on the day on which received.
2. The duty of answering inquiries should devolve upon the credit manager himself, or on a responsible and qualified assistant, who is able to add to the ledger experience on hand other valuable facts known to the department inquired of.
3. The receiving department must give its exact experience so essential to the maintenance of this important institution.
4. Finally, the National Association of Credit Men urges the receiver of an inquiry to correct abuses of the interchange system

on the part of the maker, thereby assuring progress and wholehearted cooperation.

Similar rules of ethics have been prepared by the Robert Morris Associates for the guidance of bankers and credit managers. These rules apply especially when letters take the place of the forms above illustrated, and may be divided into three parts, as follows:

Rule Urging the Importance of Trustworthiness

The first and fundamental principle is the sacredness of credit information. Any betrayal of confidence on the part of receivers of information brands them unworthy of trust and consideration.

General Rules Applying to the Inquirer

1. Information should be asked for only when actually needed, for indiscriminate use of the system imposes unnecessary burdens.
2. The object and scope of the inquiry must be conspicuously indicated in every letter of inquiry.
3. If several inquiries on the same name are forwarded simultaneously to institutions in the same city, this fact should be plainly stated.
4. In using form letters, it is essential that they bear the signature of the inquirer in order to establish responsibility for the facts stated therein.
5. Inquirers must never seek information from their competitors with a view to determining the desirability of soliciting the accounts investigated, unless the object is frankly stated.

General Rules Governing the Department Inquired Of

1. The recipient of an inquiry should carefully read each special letter of inquiry in order to enable him to answer the questions contained therein specifically.
2. In answering inquiries it is essential that all the facts available bearing on the subject under review be disclosed, if a full understanding of the case is to be gained.
3. No sources of information should be disclosed without permission in replying to inquiries.

Objections to Direct Interchange.—Notwithstanding the advantages gained through close contact between the members of the Credit Men's Association which the direct interchange system induces, nevertheless many significant objections are to

be found. Foremost among them is the tremendous multiplicity of investigations inevitably resulting therefrom. Considerable time, for both givers and receivers of information, would be required were this widely adopted as a means of securing ledger experience. For example, were a grocery name being investigated, it would be safe to assume that each of a dozen or more houses dealing with the subject would inquire of each of the others as to his experience, involving in this instance no less than 11 replies concerning a single name. The system, therefore, is both burdensome and inconvenient, except when used sparingly to supplement information secured from other sources.

In the second place, numerous inquiries concerning a risk, particularly when in weak financial condition, may arouse undue suspicion in the minds of creditors inquired of, to the detriment of the subject under investigation, and ultimately injurious to themselves. In the third place, the system lends itself to abuse. No expense being involved in the matter, many unscrupulous credit managers are likely to take advantage of the situation and make indiscriminate investigations not only of existing accounts, but also of prospective customers.

SELECTED REFERENCES

Brewster, S. F.: "Legal Aspects of Credit," Pt. IV, chap. 17.
Ettinger, R. P., and Golieb, D. E.: "Credits and Collections," pp. 142–150.
Prudden, R. F.: "The Bank Credit Investigator," chaps. 9, 10, and 11.

CHAPTER X

INTERCHANGE OF LEDGER EXPERIENCE THROUGH INTERMEDIARIES

To obviate the difficulties incident to the direct exchange of ledger experience among credit grantors, credit interchange bureaus have been established. The development of these intermediaries was so tremendous, particularly during the decade beginning with 1910, that many organizations are now to be found the sole object of which is to collect quickly and with a minimum of effort complete ledger figures and make them conveniently available to their respective members or subscribers. Thus not less than three modes of securing ledger experience through some sort of a central bureau are at present at the disposal of the alert credit manager. These means are as follows:

1. The Credit Clearing House, the National Credit Office, and others.
2. The Credit Interchange Bureaus maintained by local associations of credit men.
3. Trade credit bureaus, reporting on a single line of trade or a limited number of allied trades.

THE CREDIT CLEARING HOUSE

One of the institutions clearing information on so extensive a scale as to embrace the entire nation is, without doubt, the Credit Clearing House. Established in 1888, the organization has gradually though consistently grown to such dimensions as to constitute at present the largest of the collection agencies in the country, as well as one of the most effective. In addition, it has for years served as a center for the collection and distribution of a very extensive mass of credit information.

Method of Operation.—Each member is required to register with the agency the names of his customers and is under obligation to contribute his experience whenever one of his accounts

is the subject of an inquiry. In return, a copy of the report summarizing the data thus assembled from all interested parties is furnished each contributor. To insure absolute accuracy, each member specifically agrees to substantiate all or any of the items submitted, should he be called upon to do so.

The information gathered by this agency consists primarily of ledger figures compiled from every important wholesale market. Moreover, the subjects covered may submit their financial statements if they desire to do so. When statements are furnished, their contents are merely added to the report without any attempt at analysis and interpretation, thereby precluding the entrance of biased personal opinion.

Functions.—As already implied, prominent among the services rendered by the agency is the credit report furnished inquirers upon request. The principal feature of this report consists in an array of ledger experiences, giving the symbol representing the contributor, the highest credit extended, the amount of order, amount owing, amount due, manner of payment, terms of sale, and general remarks of material significance. These experiences are arranged impartially by districts. References do not represent the choice of the debtor, nor are the contents of the report disclosed to him.

At the bottom of the report there appears a summary in percentages of the current investigation to which all previous clearings are added in similar manner. The mode of arriving at this convenient index as to the manner of payment is very simple. Thus, if out of 30 houses reporting on a risk, 20 disclose slowness in payment, this fact will appear at the foot of the report as follows: "30 payment experiences, 60 per cent slow."

A comparison of the index representing a number of clearings will at once reveal the direction in which the merchant's business is moving.

Following the index relative to payment experiences, the extent of all attempts to place unusually large orders, or to establish credit relations with a new group of houses, is recorded also in percentages. This is commonly known as the "New Credit" index. It is arrived at by computing the percentage of the reporting firms from whom new credit was asked. When coupled with the index reflecting manner of payment, it affords

an excellent barometer of the debtor's present financial condition.

Another function of the Credit Clearing House is to warn its members by special notice when demands for new credit are unusually numerous, suggesting that a report be consulted in order to ascertain the true condition of the risk. Simultaneously, the subject of the notice is given an opportunity to explain the reason for his increased demands, and, if deemed reasonable, the explanation is transmitted to all parties concerned.

Credit Checking.—The agency also offers to interpret reports for its members and render credit decisions as well as guarantee shipments. Under this system, should a credit manager be in doubt concerning an order in hand, he may, instead of asking for reports, consult the Credit Clearing House, where he will be told whether or not shipment should be made. If losses are incurred because of improper decisions, the agency is obligated to pay the amount involved. In case a merchant is advised not to ship, a detailed report purporting to show reasons for the decision rendered is immediately furnished the inquiring party.

This service obviously has its advantages and disadvantages. Concerns whose volume of business does not warrant the employment of a credit manager may find the service of much value. Moreover, much time and worry would be saved by this means when an immediate ruling on a doubtful risk is urgently demanded. It is not unlikely, however, that, because of the risks involved, the agency will be prone to exercise undue care and caution in rendering decisions and, through its ultra-conservative attitude, cause a curtailment in the volume of business of its subscribers utilizing this special phase of its service, for its success is not so much tied up with the volume of business done by the insured as it is with the amount of loss incurred. The most important objection to "credit checking," as the service is termed, however, lies in the growing tendency toward widening the gap between selling houses and their customers, thereby still further accentuating a situation which has already reached an acute stage. If some measure of direct contact is to be preserved, credit checking should be regarded with suspicion.

CREDIT INTERCHANGE BUREAUS

Organization and Purpose.—The purpose of the Credit Interchange Bureau system of the National Association of Credit

Men, as set forth in some of the charters, is to provide an impartial medium between debtors and creditors and between creditors themselves, to establish a system whereby those who are interested in any accounts may freely and unreservedly interchange the facts contained in their ledgers: (1) without the necessity of direct reference, each to the other; (2) without divulging the information under their own name; (3) and receiving, in exchange for data contributed by them, a summary of experiences of all others interested in the account.

The system embraces at the time of this writing 57 Interchange Bureaus. Each bureau is an independent corporation under the supervision and control of the officers of the local Association of Credit Men, is not organized for profit, and its charges for services are so fixed as to cover merely the cost of operation. All of these bureaus, together with the Central Credit Interchange Bureau maintained at St. Louis, are under the direct supervision of a committee of the National Association of Credit Men, and the manager of the Credit Interchange Bureau Department of the National Organization. Each bureau is inspected annually by the manager of the Credit Interchange Bureau Department, and, in the event of emergencies or complaints on the part of one or more of its members, a special inspection may be conducted. The National office also retains the power to recommend to the local board of directors the dismissal of its bureau manager under the penalty of expulsion from membership in the National Association of Credit Men in case its recommendation remains unheeded, unless satisfactory cause for ignoring it is duly given.

The membership of this bureau system is strictly limited to manufacturers, wholesalers, jobbers, and bankers, and the accounts dealt in are those of business firms and not of individuals.

Method of Operation.—Each member is designated by a symbol, usually consisting of a number. In a few instances the symbol constitutes a combination of a letter and number, to wit, D-65, the letter ordinarily referring to the trade division in which the member is classed. The tendency, however, seems to be in the direction of the former practice. It is needless to say that the key bearing the code numbers is carefully guarded so as to preclude identity of concerns reporting. Each individual firm, however, is notified of the code by which it is to be designated.

One of the first requirements of new members is to file with the bureau a complete list of customers, so that a card may be made out immediately for each subject. These cards are arranged alphabetically in a "customers' list" file, and contain the name and address of the account, and the symbols of the members doing business with him. To supplement the information originally submitted, members are also required to furnish records of first orders on forms provided for the purpose (see Fig. 22), for it is obvious that the prompt filing of new accounts is essential to a complete clearance.

At its inception, each local bureau is required to determine its zone of direct interest. Such a zone usually embraces an area in which approximately 60 to 75 per cent of its members' business

CREDIT INTERCHANGE BUREAU
NATIONAL ASSOCIATION OF CREDIT MEN
Columbus Association of Credit Men
410-11 NEW FIRST NATIONAL BANK BLDG.

RECORD OF FIRST ORDERS — **NOT FOR INQUIRIES**

Name	Name .....
Town..... State.....	Town..... State.....
Street Address.....	Street Address.....
Name	Name .....
Town..... State.....	Town..... State.....
Street Address.....	Street Address.....
Name	Name .....
Town..... State.....	Town..... State.....
Street Address.....	Street Address.....

Promptly Recording First Orders Will Enable Bureau To Make Complete Clearance **NO.**.....

FIG. 22.—Record of first orders sent to the bureau.

is transacted. The direct interest zone being definitely determined, the office forwards to the Central Bureau at St. Louis all names of customers dealing with its members, who are located outside its own zone. The Central Bureau, in turn, makes out a card for each extra-zone subject thus reported, containing the code numbers of the various bureaus interested in him. In this manner, as will be seen shortly, the Central Bureau serves in the capacity of a clearing house for the Interchange Bureaus of the entire system.

In addition to the customers' list card file, the bureau is provided with a report "folder file," containing master sheets, the separate items making up the master sheets, and several copies of each of the latest clearance reports. The folders are usually filed alphabetically, although a combination of geographic and alphabetical arrangement is not uncommon.

Inquiry tickets are furnished each subscriber. The use of these blank forms is restricted to current accounts and to prospective customers whose applications for credit accommodations are actually in hand. Furthermore, the inquiring party is required to submit his experience with the subject each time an inquiry is made, and to indicate whether or not he desires a preliminary, and consequently incomplete, report in the event a completed report cannot be rendered without first resorting to an investigation which necessarily consumes more time. Every inquiry ticket is signed by placing the inquirer's code in a space provided for the purpose in the lower right-hand corner of the form (see Fig. 23).

SUBSCRIBER'S INQUIRY TICKET

CREDIT INTERCHANGE BUREAU
NATIONAL ASSOCIATION OF CREDIT MEN
Columbus Association of Credit Men
410-11 NEW FIRST NATIONAL BANK BLDG.
Columbus, Ohio

No member shall request a report unless he has a current account with, or an application for credit
Please secure a report on: Date.....

Name ..... Business.....

City..... State.....

Street No ..... Formerly located at.....

Also uses style..... Successor to .....

Our experience as follows: REPORT AMOUNTS IN DOLLARS ONLY. First Order $ ..... Date of Last Sale .....

HOW LONG SOLD	HIGHEST CREDIT	AMOUNT OWING	AMOUNT PAST DUE	UNFILLED OR FIRST ORDERS	TERMS OF SALE	MANNER OF PAYMENT: Discounts	MANNER OF PAYMENT: PAYS When Due	MANNER OF PAYMENT: DAYS SLOW	COMMENTS

COMMENT: Place X in front of answer. USE CAUTION

☐ Account Secured. ☐ Pays by Notes. ☐ Pays Drafts. ☐ Makes Unjust Claims. ☐ Returns Goods Unjustly. ☐ Claim in Attorney's Hands.
☐ Checks Protested. ☐ Notes NOT Paid When Due. ☐ Takes Excessive or Unearned Discounts. ☐ Countermands Orders. ☐ Collected by Attorney. ☐ Refused, (Give Cause)

SPECIAL COMMENT:.....

Use back of this ticket for references, or names of houses (with complete addresses) known to be interested.

CHECK WITHOUT FAIL: ☐ Send us the first or preliminary reports. ☐ Send us *ONLY* the completed report. *NO.*.....

FIG. 23.—Subscriber's inquiry ticket.

Upon receipt of an inquiry ticket, the report file is immediately consulted and, if a copy of a recent clearing is available, a report may at once be furnished. Since several requests may come in for information concerning the same subject, it is customary and convenient to maintain in the folder file extra copies of all recent investigations. Should the last report prove out of date—over 60 days—or in the event no report is available concerning the subject of the inquiry, the customers' list card file is thereupon consulted with a view of determining from the code numbers appearing on the subject's card the names of members reported to have dealings with him. As soon as these

code numbers are ascertained, a "subscribers' reply ticket," similar in form to the "subscribers' inquiry ticket," is sent to each of the members selling the subject. The two forms referred to differ only as to color, as a rule the former being white and the latter yellow. A pink form of substantial similarity may also be sent to non-subscribers known to have dealings with the risk, who are promised a copy of the completed report, gratis, in return for their respective contributions. In all cases, the name and address of the party under investigation is already filled in by the bureau.

When the reply tickets containing the experiences of the houses selling the account are returned to the office, the information is copied and tabulated on a master sheet, usually with duplicating ink, by means of which a sufficient number of copies may be made on a "ditto" machine. Upon completion of this task, a copy of the report is mailed to the member making the inquiry. A free reciprocal copy is also furnished each contributing member and several copies are retained for the folder file.

If a complete investigation is called for, additional ledger facts must necessarily be secured from bankers and merchants located outside of the bureau's direct zone of interest. To accomplish this, two additional steps must be taken. Each bureau is furnished with a zone map from which it can readily be ascertained whether or not other bureaus consider the subject of the inquiry as residing within their respective zones, for zones of direct interest are almost consistently overlapping. An "Inter-Office and Central Bureau Inquiry Ticket" (see Fig. 24) is thereupon forwarded to each of the bureaus within whose zone the customer in question is located. These bureaus assemble the information in their respective territories in a fashion similar to that described in previous paragraphs, and the filled-in forms are mailed direct to the inquiring bureau just as received from the various reporting houses, without any attempt on the part of the answering offices to tabulate the data assembled, thereby resulting in a substantial saving of expense and labor, and inducing prompt replies.

In order to determine the extent of a subject's activities in markets other than those situated within the several zones in which he is located, an "Inter-Office and Central Bureau Inquiry Ticket" is addressed to the Central Bureau at St. Louis, whose function it is to determine from its card file the various bureaus

Interoffice and C. B. Inquiry Ticket

Inq. Bur. No......

Ans. Bur. No......

CREDIT INTERCHANGE BUREAU
NATIONAL ASSOCIATION OF CREDIT MEN

Date.....

From Bureau No......

To Bureaus No......

PLEASE CLEAR FOLLOWING AND FORWARD RESULTS PROMPTLY:

Name.....

Street.....

City.....

State.....

Business.....

Formerly located at.....

Also uses style.....

Successors to.....

References: (with complete addresses)

.....

.....

.....

.....

.....

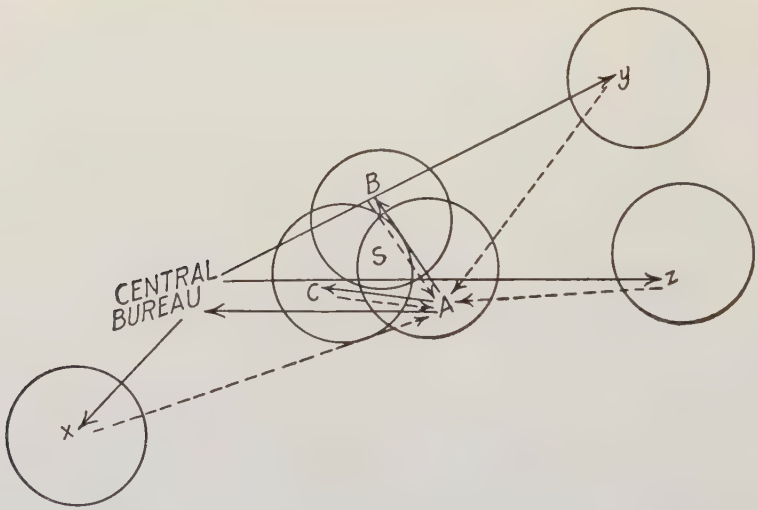
(Use other side if necessary)

FIG. 24.—Interoffice and Central Bureau inquiry ticket.

reported to have dealings with the customer inquired upon. As already indicated in another connection, the Central Bureau acts as a clearing house for information from offices outside of whose zone the given customer resides. An interoffice ticket is then forwarded to each of the bureaus whose code numbers appear on the customer's card requesting a clearance within their respective zones for the benefit of the inquiring bureau, to which the information as received from the various reporting firms is mailed direct by the respective answering offices.

In the event a preliminary report has already been issued, supplements to the original are subsequently made up of the additional experiences received from outside bureau points and mailed to the inquiring member, and a free reciprocal copy of the final report is also furnished each contributor of ledger data.

In order to comprehend clearly the modes by which clearances are made and reports compiled in response to an inquiry by a member, the following diagrammatic illustration is submitted:



In this illustration *A* represents the bureau receiving an inquiry from one of its members concerning the subject *S*, who happens to be located within three bureau zones as delineated by the circles. The solid lines indicate the routes followed by requests for information mailed by *A* and the Central Bureau at St. Louis, respectively, while the broken lines show the routes followed by the replies to the inquiries.

Contents of a Credit Interchange Report.—The ledger facts gathered from the various sources described are tabulated by geographical units, under each of which the proper reporting firms are listed more or less indiscriminately. The report gives in the first column the line of business of each contributor, preceded by the symbol by which he is identified. Then follow the individual experiences, showing length of time sold the account, highest credit extended, amount now owing, amount past due, whether there are unfilled or first orders in hand, terms of sale,

CREDIT INTERCHANGE BUREAUS
NATIONAL ASSOCIATION OF CREDIT MEN
Executive Offices: 41 Park Row NEW YORK N.Y.
Central Bureau 510 Locust Street, ST LOUIS, MO.

The accuracy of this Report is not guaranteed. Its contents are gathered in good faith from members and sent to you by this Bureau without liability for negligence in procuring, collecting, communicating or failing to communicate the information so gathered.

REPORT ON:

SMITH'S HOTEL COLUMBUS OHIO 5-15-23

BUSINESS OR SUB.	NEW LONG SOLD	DATE OF LAST SALE	HIGHEST CREDIT	AMOUNT OWING	AMOUNT PAST DUE	UNFILLED OR FIRST ORDERS	TERMS OF SALE	MANNER OF PAYMENT: DISCOUNTS	PAYS WHEN DUE	DAYS SLOW	COMMENTS
(22625 COLUMBUS)											
7 CRMRY	YRS	3-16	225	45	45		30			30-60	
17 ELEC	YRS	11-9-22	88				30	X		30-60	
100PRTG	S.YRS	3'23	352						X		
1 GROC	YRS	3-16-23	4 97	497	497		30			60	
PPR	YRS	MARCH	108	10			30			30-60	
GROC	1918	3-15-23	300	285	285		30			30-60	
D.G. GRAND RAPIDS	YRS	12-5-22	1000	650	650					60-90	
FURS	YRS	11-10-22	3500	1600	1600					3-6MOS	

FIG. 25.—Credit interchange report issued by the Interchange Bureaus of the National Association of Credit Men.

manner of payment, and comments. Under "manner of payment" three classifications are to be found, into which all customers may be conveniently divided. These purport to show whether the subject discounts his bills, pays promptly at maturity, or permits his accounts to lapse into slowness. If slow, the extent to which that is true is indicated, usually in days.

Changes in payment and similar data of material significance, either favorable or derogatory, are generally included in "comments." This item, consequently, discloses whether claims against the subject have been placed in the hands of an attorney or a collection agency, whether the subject returns merchandise

unjustly, whether further credit has been refused, and the like (see Fig. 25).

Interpretation of a Credit Interchange Report.—From the data presented in the first column, the wide-awake credit manager may visualize the kind of business the risk is engaged in, and the proportionate composition of his stock of goods. An opportunity is also afforded to study the distribution of purchases between various markets and the reasons therefor.

How Long Sold.—The length of time sold a customer has a significant bearing on the relative merit of a contributor's experience. Other things being equal, the value of the comments, as well as that of the statement concerning manner of payment, varies in direct proportion with the length of time over which dealings have extended.

Date of Last Sale.—Date of last sale or last shipment tends to disclose the customer's current buying activities. Unusual buying activity serves as a danger signal, calling for an immediate inquiry into its causes and purposes. The date of a last sale also denotes the recency of the information contributed by the house, thereby aiding in the exact determination of its relative value.

Highest Credit.—The highest credit extended reflects the opinions of other creditors respecting the subject, and serves as a valuable guide, particularly when the experiences appear extensive from the standpoint of both time and sales volume.

Amount Owing.—Obviously, one of the most important columns is that displaying the amount owing. Without a knowledge of a concern's aggregate indebtedness as revealed roughly under this heading, credit managers may be led to extend credit unwisely, because of the influence exerted by the action of other creditors in extending large lines to the firm in question. Checking the amount owing against the accounts payable item of the firm's balance sheet, if submitted by the subject, will tend to uncover fraudulent intents and designs, if any, prior to making shipment.

Amount Past Due.—If the ratio of past dues to amounts owing is high, the risk should be regarded with suspicion, and *vice versa.* Once an account lapses into slowness, the firm is in all probability weakening financially, particularly with regard to its working capital. Viewing it from the standpoint of the selling house, a quick turnover of accounts receivable is one of

the most important factors. An average slowness of 30 days on an annual capital turnover of, say, a million dollars, represents a considerable sum tied up unproductively, costing the company not less than $16,800, assuming that the capital would be turned twice a year if remittances were to be made in accordance with terms of sale, and that the average annual rate of return on working capital would equal 20 per cent. Moreover, further loans from banks would be necessitated, the effect of which may be to strain the selling firm's credit to the danger point. Add to what has been said the possibility of the past dues becoming a partial or total loss, and the importance of this information will be more readily and fully appreciated.

Unfilled or First Orders.—The amount and number of first orders show the extent to which new credit is sought by the customer. If unusually large, a thorough investigation into the causes should be conducted prior to accepting the order. In the course of such an investigation it is essential to ascertain whether the subject is shifting his purchases to a new set of creditors in order to elude settlement of his accounts, or whether he is stocking up with merchandise preparatory to making an assignment or voluntarily going into bankruptcy. The report itself may unmistakably reveal these intentions, when properly interpreted. Thus, when many new accounts are opened at the time that the past dues to old accounts run high, it is perfectly obvious that the subject is attempting to elude payment of his bills.

If any large number of first orders are revealed while at the same time large amounts of past dues are shown, it becomes evident that the customer is allowing his old accounts to lapse into slowness and is endeavoring to obtain additional credit in new markets.

A large number of unfilled orders may indicate that creditors are withholding shipment pending investigation. In arriving at this conclusion the type of business should be taken into consideration. In many businesses it is customary to order months in advance with the understanding that shipment is to be delayed.

First and unfilled orders should be taken into consideration in arriving at the aggregate potential indebtedness and present buying activity. To distinguish between unfilled and first orders,

this column should be read in connection with that displaying the length of time sold the risk under consideration.

Terms of Sale.—From the terms of sale, the credit manager, knowing the customary terms prevailing in the various trades, should be able to ascertain the extent to which confidence is reposed in the subject by other creditors. An inferior or doubtful risk seldom receives goods on regular terms. He is usually required to purchase on a C.O.D. basis or to make cash settlement for value received. On the other hand, exceptionally good risks are favored with better terms, involving a longer credit period, or a larger cash discount, or both.

Manner of Payment.—The manner in which a merchant takes care of his bills is an excellent indication of his financial responsibility. The significance which the manner of payment has on a concern's credit standing and on the successful management of the seller's house has already been discussed fully in another connection. Suffice it to state that slow-pay risks accustomed to take overtime are extremely troublesome. Some of these accounts may be perfectly safe, but because of carelessness they are chronically and habitually slow; others are apt to become in time poor-pay customers, requiring suits or other drastic measures to enforce payment.

The number of slow-pay customers is quite large. These vary in degree from the little slow to the very slow, the former meeting their obligations with fair promptness, whereas the latter delay payment until actually threatened with drastic measures. Hence, the importance of knowing the degree of slowness.

Another thing that needs watching under this heading is the size of accounts which are discounted or paid when due. Some unscrupulous merchants make it a practice to meet their obligations on a few small accounts with great promptness in order to use them as references and otherwise make a favorable showing. Again, prompt payment of small accounts at the expense of the larger debts frequently represents a situation where the debtor is at least temporarily confining his buying to amounts considered essential to the operation of his business, for which prompt settlement must be made.

Advantages of Credit Interchange Bureaus.—They furnish ledger information the reputation of which for freshness and reliability is already well established and recognized by many experienced credit managers. Files are revised at frequent

intervals, usually about every 60 days—a feature peculiar to the system. Moreover, reports are furnished within a short time after receipt of inquiry. This, of course, depends upon the availability or lack of recent clearance reports on file; also upon the extensiveness of the investigation to be conducted. In any event, a preliminary report can be rendered within a surprisingly short period of time. And even a clearance on a national scale seldom consumes more than ten days to two weeks.

One of the paramount advantages of the system lies in the scope of its activities, with respect to both territory and lines of trade. The service is national in scope, making it possible for a credit grantor located, say, in Cleveland, to learn through its reports how a customer residing in Nashville is paying his creditors in New York, Philadelphia, St. Louis, Chicago, and elsewhere. As trade expands and as the number of bureaus increases, this service will, no doubt, assume still larger dimensions, thereby permitting of more intensive cultivation. The service not only knows no restrictions as to area, for the same is true with respect to lines of trade. All kinds of business are covered in their investigations, so that complete data respecting merchants handling more than one line can be accurately communicated.

Of no little importance is the reciprocal feature underlying the system. Because of it, a further and rapid spread of the scope of its operations is more than assured, resulting in larger membership, wider area, more complete, and, consequently, more valuable service. Furthermore, the information in its files is frequently revised and, through the gratuitous reciprocal reports guaranteed by the system, subscribers are aided substantially in watching accounts, changes in buying habits, and methods of payment. Finally, the system affords an automatic mode of keeping subscribers' files fresh and up to date, for, when an inquiry respecting a customer is received by a member, it often serves as a signal calling for a rechecking and revision. In this manner, the latest credit facts are compiled and recorded in the appropriate files.

The Credit Index.—Approximately two years ago, C. C. Henking of the Henking-Resener Company, Huntington, W. Va., conceived the idea that the several bureaus could further contribute to the progress of the credit profession by constructing and issuing a periodic credit index. The Huntington office was

the first to inaugurate the plan, hence the Huntington Credit Index. Although the idea is relatively new, it has already gained considerable momentum and it bids fair ultimately to cover the entire nation.

The process of constructing a credit index is relatively simple. If a weekly index is desired, the bureau needs only determine from its clearances the amount owing, and the amount past due. This can be accomplished by adding these totals of the two respective columns of all clearances made during the week. By subtracting the amount past due from the amount owing, the sum currently collectible or the amount which is in liquid form is arrived at. Finally, by dividing the sum currently payable by the total owing, the percentage currently collectible is obtained. This percentage constitutes the credit index, and purports to show the extent to which accounts are collectible. To illustrate, let us assume that the amount owing and amount past due are $400,000 and $100,000 respectively. Deducting the amount past due from the amount owing, we arrive at a figure showing current payments or the sum currently collectible ($400,000−$100,000=$300,000). The sum correctly collectible divided by the amount owing results in the credit index for the period covered by the experience, which is in this instance 75 per cent ($300,000 : $400,000).

Such an index, when graphically extended from week to week, tends not only to reflect the condition of credit in a given district, but also to point out the direction which the collection work is following. When the curve rises, improvement is reflected, and *vice versa*. *Knowledge* of the general movement in collections for some time past will foster and encourage credit managers to study the various factors responsible for the fluctuations, so that, unless these causes are chronic and inherent in the modern social and economic system itself, remedies may be effectively applied. The immediate advantage of a credit index from the standpoint of the subscriber, however, lies in the ease with which he may utilize it in comparing with it his own progress in collections. Under these circumstances, a credit manager can effectively check his own work and know whether or not he is following the general trend, which may cause changes in his methods leading to improvement in case his collections fail to keep pace with the general movement. A diligent study of the variations in collections and causes therefor, if found to be due to seasonal differences and similar unavoidable factors, will, nevertheless,

aid credit managers in determining the various periods of good and poor collections, respectively. Such knowledge will, no doubt, facilitate long-range planning and make for better and more scientific business management.

Should a substantial number of bureaus adopt the plan, it is conceivable that a credit index of a national scope will be constructed similar to that made during the week ending May 30, 1923, in which over 50 bureaus participated, involving 7,743 clearances of 52,777 payment experiences, whose outstandings exceeded $10,000,000. This sort of an index, it is obvious, becomes particularly valuable when followed up from week to week, for, since the data is arranged by Federal Reserve Districts, it permits of a study in collection progress as between various regions, so essential to sellers in extensive territories.

Objections to Credit Interchange Bureaus.—Notwithstanding its numerous advantages, the bureau system has been severely criticized; most of this criticism the reader will concede to be unjustifiable. Some critics claim that the bureau tends to substitute personal contact for direct interchange between members. This is, it must be asserted, only partially true. The effectiveness of the system does, no doubt, tend to take the place of the other and cruder methods, as far as regular ledger experiences are concerned. Direct interchange, however, can still be profitably utilized for the sake of acquiring information which normally does not appear in print and which may decide conclusively the turning point in a given case.

A second group of critics claims that the bureau membership will never attain such dimensions as to become of real importance. In support of their view they point to a large number of credit managers who refuse to subscribe for the service because they feel that it will be necessary for them to give more information concerning their trades than that received. Again, some credit managers are loath to divulge information respecting a customer who is temporarily embarrassed for fear of causing undue injury to him. Refusal or neglect to furnish all facts necessarily limits the scope of the report, and fails to disclose the exact standing of the subject.

In reply to these critics it may be observed that their arguments run against the current of actual conditions. The probable growth and development of these bureaus is not a matter of library philosophy, but lies in the realm of actuality. Great and

consistent progress is to be noted from the very inception of the enterprise. To be sure, it is still far from having attained completeness and perfection, but if the future growth is to be judged by the progress made heretofore, the prospects are exceptionally bright.

Cost of Credit Interchange Service.—To purchase a membership in a Credit Interchange Bureau, a certain minimum number of reports must be subscribed for. The sum paid for these, as well as additional reports, varies with different bureaus. Some charge a flat rate of $1 per report; others employ a sliding scale, on the theory that the work is carried on on a decreasing cost basis, hence the larger the initial number of reports subscribed for the smaller the charge per unit. The tendency, however, is toward the adoption of a uniform charge of $1 per report. In this connection it should be observed that, notwithstanding the charge of $1 per report, the actual cost is considerably reduced by the large number of free reciprocal reports furnished members by the bureau, so that in many instances the *real* cost may not exceed 10 cents each, a feature offering no inconsiderable inducement to the sophisticated credit manager.

TRADE CREDIT BUREAUS

Types of Trade Bureaus.—Various trade associations and boards of trade have established their own credit bureaus. These are operated and managed in conjunction with the organization to which they form an adjunct. Thus, there is a Millinery Jobbers' Association Credit Bureau serving only one group of middlemen in a single trade; a Lumbermen's Credit Association operated as a special interchange bureau for lumbermen; and many others of similar composition. The purpose of these organizations is essentially the same as that for which bureaus have been founded by local Credit Men's Associations, namely, to facilitate the exchange of information among credit grantors and to aid their members in guarding against extending accommodations to parties unworthy of credit.

From the standpoint of methods employed in conveying information to members, all trade bureaus may be divided into two classes, although many minor gradations will be revealed upon closer analysis. One group merely furnishes the inquiring member the names of concerns dealing with the risk for his

own independent investigation. The other class of bureaus conducts the investigation and renders complete reports.

Incomplete System.—A bureau operating under this plan requires all of its members to register the names and addresses of all their customers. Each member is identified by a symbol, usually consisting of a number. A key containing the names of the members with their respective numbers is subsequently made up and distributed among the members. The symbols of members dealing with a given risk are thereupon recorded on a card made out for the purpose and kept up to date by noting all changes in trade connections. Upon receipt of an inquiry either by telephone or by correspondence, the office consults the customer's card, and informs the inquirer of the codes of all members known to have dealings with the risk. Simultaneously, the inquirer's number is added to the customer's card, if not already there, for by this mode the file is kept up to date.

To complete the investigation, the inquiring member ascertains by means of the key in his possession the names of the houses doing business with the risk. The credit manager may then, at his discretion, resort to one of several means at his disposal. He may personally call upon the respective concerns; he may have a credit department investigator visit them; or, finally, he may communicate with them by means of the telephone or through correspondence.

Complete System.—A bureau operating under this plan follows methods and processes somewhat analogous to those employed by the Credit Interchange Bureau system of the National Association of Credit Men. Members are identified by symbols, a key is made up, a complete list of customers is required of each member, and a card is made for each customer and filed alphabetically in the customers' card file. From this point on, however, slight differences in method of operation are to be noted. In the first place, the card contains not only the symbols of members doing business with the risk, for all pertinent facts needed for a complete written report are recorded thereon. All inquiries received during the day are assembled and classified according to members dealing with the subject inquired upon. Lists are then made up, one for each member affected, bearing the names of all his customers about whom inquiries for information have been received during the day. Some bureaus list daily all the names to be investigated during

the day on a single sheet, and send a copy of that sheet to each member. This method is practical with only a limited membership. Each member indicates on the list opposite the proper name his experience with that customer, and upon returning these sheets to the office, the data is tabulated and a report is compiled and sent to the inquiring party. Each contributing member is also entitled to a gratuitous report. Many of the bureaus organized in recent years, however, follow in practically all details the methods pursued by the Credit Interchange system of the National Association of Credit Men (see Figs. 26 and 27).

Form INT 51 100M 11-21 ®

INFORMATION BLANK

Date_____1922

Kindly give us your experience with:

Name_____ Located at_____

Also known as_____

Formerly in business at_____

How Long Have You Sold	Spring 1921 Gross Sales	Fall 1921 Gross Sales	Spring 1922 Gross Sales	Highest Credit	How Paid	Total Amount Owing on Account and Notes	Amount Owing on Acc't	Amount Past Due on Acc't	Owing on Notes	Owing Past Due on Notes	Amt. Orders on Hand not charged
Beas											
RETURNED											

IF NO RETURNS—SAY SO EACH SEASON.

Are you secured and how?_____ Is Claim in hands of Att'y?_____

Ever refused credit?_____ Why?_____ Makes unreasonable Claims?_____

Do you know of any Chattel Mortgages?_____ **RETURNS GOODS UNJUSTLY?**_____

Remarks:_____

		Spring	Fall	Spring	Fall	Highest Credit	How Paid
IF SOLD ONLY BEFORE ABOVE SEASONS	SALES						
	RETURNED						

No._____
Please Sign Your Number

NOTE—Do not fold. Return in our addressed envelope furnished you.

FIG. 26.—Information blank used by trade credit bureaus.

Advantages of Trade Bureaus.—There is apparently nothing to recommend trade bureaus operating under the incomplete system, save its cheapness. But the value received is no greater, proportionally, than the amount paid for it. For the trade organizations operating under the complete report plan, however, many praises are sung by its adherents. Reference to Fig. 27 will at once reveal the principal, and perhaps only, reason for their success. Obviously, different trades are interested in different items, largely depending upon the peculiar practices characteristic of the respective lines of business. A millinery jobber, for instance, in analyzing a report, lays chief emphasis on re-

MILLINERY JOBBERS ASSOCIATION CREDIT BUREAU

Chicago, JULY 27, 1923 Z 1923

Gentlemen: Result of an Investigation as to GATHERED JULY 14 CHICAGO, ILL. & BRANCHES

O. B. & O. CO. MICHIGAN AVE

How Many Seasons Have You Sold?	FALL Gross Sales 1929	Returned	SPRING Gross Sales 1931	Returned	FALL Gross Sales 1931	Returned	High-est Credit	How Paid	Total Amount Owing on Account & Notes	Amount Owing on Account	Amount Past Due on Account	Owing on Notes	Owing Past Due on Notes	Amount Orders on Hand Not Charged	Attorney has Claim Makes Unreasonable Claims Returns Goods Unjustly Are You Secured and How? Ever Refused Credit and Why? Do You Know of Any Chattel Mortgages?
	2860	385	4130	57	756		2350	DIS	1120	1120	0			72	
	1630		2203	45	65		923	DIS	7	7	0				
SEV	283	50	8023	154	436		6502	DIS	436	436	0				
SEV	19045	967	22979	670	14		7485	DIS	1173	1173	0				
SEV	1215	21	1050	22			1119	DIS	0	0	0				
ONE			16				16	DIS	0	0	0				
YRS	3599		2266				1148	DIS	17	117	0				
SEV	2120	53	553				3429	SLOW	227	227	0				
ONE			589				300	DIS	0	0	0				
	1462		535		78		455	DIS	256	256	0				ST. LOUIS AND CHICAGO ACCTS
	271		427	15	6		119	DIS	65	65	0				ST. LOUIS ACCT
			124		59		59	DIS	59	59	0				ST. LOUIS ACCT
			260				143	DIS	0	0	0				DALLAS TEX ACCT
			139				105	DIS	105	105	0				FT. WORTH ACCT
			334				289	DIS	45	45	0				KANSAS CITY ACCT
	1268	80	4081	27				DIS	882	882	0				
	2000		5000					DIS	0	0	0				CREDIT UNLIMITED DISCOUNTS ALL ACCOUNTS PAID FROM CHICAGO OFFICE
	21	21					896	C&D	0	0	0				
SEV	1032	17	10470	89			5910	DIS	1164	1164	0				
SEV	224		1655	46			797	DIS	47	47	0				
SEV	1854	195	1947	7				DIS	13	13	0				
SEV	1127	6	462				423	DIS	0	0	0				
YRS	2989	12	2465		12		1636	DIS	487	487	0				SOLD VARIOUS BRANCHES
SEV	5720		4142				2016	DIS	243	243	0				
	318		102				240	DIS	0	0	0				INDIANAPOLIS ACCTS
	2		572				266	DIS	21	21	0				
	650	119	2125	131			1779	DIS	0	0	0				
SEV	5837	479	5950	118			3000	DIS	1750	1750	0				
	2299	23	3671	46			1500	DIS	864	864	0			76	KANSAS CITY MO. FT. WORTH, DALLAS AND WACO TEX A/C.
	1137	14	1224	30			796	DIS	0	0	0				
			240					DIS	0	0	0				
	3335	103	1607	39			141	DIS	856	856	379				
	4050	115	2500	20			1650	DIS	0	0	0				
			135				135	DIS	80	80	0				DALLAS, TEX ACCT

FIG. 27.—Trade credit bureau report.

turned merchandise and seasonal variations in purchases, whereas in other trades the emphasis may be shifted to modes of settlement, whether by promissory notes, drafts, and the like. It is the special type of information that generally appeals strongly to various trades, although on many occasions little difference is to be discovered between trade bureau reports and those issued by Credit Interchange offices of Credit Men's Associations.

Limitations of Trade Bureaus.—These organizations often restrict their field of operation to a single class of persons or firms, such as jobbers or manufacturers exclusively, or else limit their activities territorially. In either of these cases, they are considerably handicapped in the compilation of reports, which are of necessity incomplete and, consequently, fail to reflect accurately the customer's standing. Furthermore, trade credit bureaus are at best limited to a single line of business. So long as exclusive trade shops are under investigation, so long are the results likely to prove satisfactory. When an investigation pertaining to a store handling several distinct lines of merchandise is conducted, however, obviously the information secured from only one group of sellers is totally inadequate as a basis for a credit decision.

SELECTED REFERENCES

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McAdow, F. H.: "Mercantile Credits," pp. 64–71.

CHAPTER XI

SALESMEN, ATTORNEYS, AND BANKS

Of increasing importance in modern business is the ever-growing tendency toward large-scale production and equally large-scale management. The portion of the twentieth century that has just rolled by has witnessed numerous and tremendously significant combinations and consolidations, both vertical and horizontal. Similarly, individual plants and mercantile houses have gradually and consistently expanded until they have embraced the entire national market. Because of these developments, purchasers have become farther removed geographically from their selling houses, necessitating the substitution of a most indirect contact with the trade for that of personal acquaintance. To say that such a substitution is unsatisfactory is putting it mildly. Although practically all the departments of a selling house are handicapped because of the distance separating them from the customers, none suffers quite so much inconvenience as the credit department. A personal interview of the prospective buyer is no longer feasible, and an examination, by the credit manager, of an applicant's place of business, stock of goods, store policy, and the like, prior to rendering a decision, is seldom practical. For these reasons alert credit dispensers, recognizing these limitations, seldom, if ever, fail to consult those representatives who have the opportunity of meeting the customer personally. These representatives are salesmen, attorneys, and banks.

Salesmen as Credit Reporters.—Probably the oldest source of credit information was the report submitted by the salesman who visited the customer in his place of business. And even yet the salesman's report is given first consideration, for it logically comes first, in chronological order, as a source of information, because it accompanies, as a rule, all first orders from new trade. The salesman is in many instances the only representative of his firm who may ever have the opportunity of establishing relations through personal contact with the customer.

He is the man on the ground and is, therefore, in a superior position to render particularly valuable services to his credit department.

Dual Capacity of Salesmen.—That the salesman is in an exceptional position to render valuable assistance by reporting facts based on personal observation remains undisputed. Whether or not he will supply the facts, and the extent to which the credit department is justified, as a matter of good business policy, in requiring him to serve as its agent, are questions presently to be considered. The credit manager should never lose sight of the fact that the salesman's chief mission is to sell goods. He must sell merchandise, and in many concerns he is required to do nothing else. Any additional function which will in any way conflict with his main purpose, no matter how remotely, is extremely distasteful to him and he is more than likely to resent it or else assume an attitude of indifference regarding the thoroughness with which it is performed. This is especially true when the method of compensation is based on the volume of sales, as when employed on a commission basis alone or possibly a combination of commission and salary. Under such circumstances, salesmen do not wish to be hampered by anything which apparently has no immediate favorable effect on the amount of sales, and are naturally loath to offend or embarrass a prospective customer by asking numerous questions regarding his financial responsibility for fear of driving away trade to a competitor. Again, prompted by selfish motives, salesmen are prone even to assume an antagonistic attitude toward the credit department, which, in their opinion, requires their assistance in handling accounts without reciprocating by helping to sell goods. Such an attitude undoubtedly discloses one of the inefficiencies of modern business organization, where, because of the specialization in functions on the part of different departments, sight is frequently lost of the main purpose of the entire machinery and each employee, consequently, considers himself as a department instead of company representative.

On the other hand, the credit department is fully justified in insisting upon the salesman's cooperation. This can be accomplished by pointing out to salesmen the fallacies of their arguments, for, as already treated in another connection, the work of the credit department has a very direct and significant bearing upon sales volume. If the credit manager in his dealings with

customers bears, as he should, the idea of business promotion in mind, and thus treats them considerately, he thereby aids the salesman in retaining the good will of his trade. Furthermore, nothing can be of greater value from the standpoint of the salesman who is employed on a commission basis, wholly or in part, than the securing of a quick and favorable decision on an order in hand. But to render a credit decision quickly, information respecting the risk's financial responsibility must be readily available. It, therefore, behooves the salesman, for his own interests, to remove all obstacles which may cause undue delay in deciding whether or not an order is acceptable to the house. Again, a salesman is usually required to make only one report on a customer, namely, when a first order is secured. Thereafter, he is seldom called upon to make another investigation unless the customer's account becomes decidedly unsatisfactory, and a thorough revision of the files is made necessary. It does not seem, therefore, unreasonable to require his assistance in this regard.

Salesman's Credit Reports.—In view of the foregoing, it is apparent that good judgment calls for a limited amount of information from the salesman. In justice to him, only those facts should be called for which cannot be obtained through the aforementioned channels. He should not be asked to furnish the sort of information which requires an exhaustive investigation and is, therefore, likely to cut heavily into his time and also arouse the customer's suspicion. Any deviation from this principle invariably results in purchasing data at a price beyond its value, because of the antagonism toward the credit department arising from the embarrassment of customers and consequent loss of sales.

The salesman sees the merchant in his setting and is probably familiar with local conditions. Because of these facts he is in a position to furnish the following information:

1. Kind of Business.—To a wholesale grocer, for instance, it is important to know whether or not the buying merchant handles fresh meats and fresh fruits and vegetables, for these commodities profoundly affect the rate of stock turns and the cost of doing business. A disclosure of the exact nature of the business is readily procurable from this source, since it involves a minimum of observation and no direct questioning whatever.

2. Condition of Store.—This involves a consideration of stock arrangement, window and store display, efficiency of the organization, and the manner in which customers are served. All of these are easily within the range of a salesman's observation, yet they are important. Gross neglect of any of these factors on the part of a store may eventually precipitate failure.

3. Condition and Value of Stock.—The salesman can at a glance ascertain the extent to which the merchandise inventory is out of date, which, in turn, determines the probable rate of stock turnover. He also knows the customer's buying habits, and if reckless in his buying habits he is likely to prove equally careless in his manner of payment. Again, casual observation of the prices at which merchandise is marked will reveal through the apparent gross margin the profitableness of the business. Whether or not the stock is well kept is also significant as an indication of merchandising ability. Many houses also require their salesmen to estimate the value of the stock. The author's experience with estimates submitted by various business men leads him to believe that, unless made by the sophisticated and with considerable care, they constitute mere guesses and as such are practically worthless. To be sure, the proprietor may be consulted regarding this figure, which when properly discounted, may serve as a better, though still extremely rough, indication of the value of merchandise inventory.

4. Location.—With the increase in knowledge of scientific management, the conditions affecting the location of a business are becoming increasingly important. As a result, the progressive merchant, in selecting the site for his business, studies and analyzes all the factors which make for a good location. Among others are its relation to the business center in case of shopping goods; available transportation facilities; the number of passers-by; the character of passers-by; the side of the street, whether shady or sunny in the afternoons; the location with reference to prevailing winds; environment and other similar factors. The grouping of businesses is also signficant and has a direct bearing on the probable success or failure of the concern in question. On visiting his trade, the salesman ought to be in a position, after proper coaching, to observe the aforementioned factors and on that basis arrive at a correct conclusion respecting location.

5. Local Conditions.—The salesman is in a position to keep the credit department informed of these conditions which have

a material effect upon a customer's business. Industries may be removed or shut down, crops may fail, the character of the local industries may be such as to offer only temporary employment, streets in the vicinity may be temporarily torn up, employees of transportation facilities may strike, traffic may be diverted to other streets, and the like.

6. Habits and Reputation.—Next to attorneys, probably no one is better fitted than the salesman to gather information concerning the customer's reputation. By direct questioning, assuming confidence on the part of the merchant, and through incidental inquiries in other directions, he will learn whether the customer drinks, or gambles; and he will also learn the kind of reputation he enjoys locally as a merchant and a citizen.

7. Capital Resources.—Most houses require their salesmen to furnish figures regarding a risk's capital investment in and outside the business in which he is engaged. Since, however, this information is readily procurable from other sources, it is questionable whether a salesman should be burdened with the task of acquiring it.

8. References.—Since a salesman's report usually accompanies every first order, it is essential that some reference to both banks and mercantile establishments with whom the risk has dealings be secured. These references may be obtained directly from the merchant or indirectly through inquiries directed at salesmen of other houses and other local merchants with whom connections are well established.

Form of Salesman's Credit Report.—Although many forms of salesmen's credit reports have been suggested on various occasions, few appear to conform to the principle enunciated in a previous paragraph, primarily because of the excessive mass of information they purport the salesman to furnish. A reasonable form of report should be confined to the following:

1. Date.
2. Name and address of firm.
3. How long in business.
4. Kind of business.
5. Condition of store.
6. Estimate of value of stock.
7. Is stock well kept?
8. Buying habits.
9. Location.

10. Competition.
11. Local conditions affecting the business.
12. Capital resources.
13. Buys from.
14. Banks with.
15. Remarks concerning experience, habits, and reputation.

From the above questions it is obvious that only those facts are covered which would not be obtained readily through other sources and which, on the other hand, can be secured, for the most part, by a close observation of the salesman without undue interference with his principal duty of selling goods. This form could be used advantageously by many concerns. To be sure, it should always be modified to suit a given house. Thus, if a concern offers the buyer the option to run a 15-day or a 30-day account, space should be provided for the purpose.

Value of Salesman's Credit Report.—The extent to which the credit data submitted by a salesman should be relied upon depends, in large measure, upon his ability, assuming willingness on his part to do so, to size up a situation and arrive at correct and reliable conclusions. If he is a keen observer and, in addition, possesses knowledge of what constitute good business methods and policies, greater reliance can be placed on his reports than when his opinions are merely a result of unsophisticated guesswork. Another factor determining the strength of his reports is the extent to which he permits himself to become biased by his desire to roll up volume. In the very nature of things, salesmen are prone to be somewhat over-optimistic and may thus allow their judgment to become clouded by their enthusiasm. A third factor consists in the willingness of the salesman to cooperate with the credit department which, in turn, depends upon the treatment accorded customers and salesmen by the latter. Lastly, it is comparatively safe to assume that, when answers are required to a limited number of points, the results will be more satisfactory. Irrespective of all the factors mentioned, it should be borne in mind that, after all, a substantial part of the salesman's report is essentially in the nature of opinions which are, therefore, of no higher quality than that of the person giving them.

In addition to reports, salesmen are in many houses required to review, with the credit manager, the customers' list periodically, usually twice a year. This contact affords an opportu-

nity to secure additional pertinent data pertaining to the accounts under discussion and to make the salesmen realize the necessity for cooperation if larger sales are to be made. These contacts should always be encouraged, for they result in the establishment of close and more helpful relations between the two departments thus represented.

Attorneys as Credit Reporters.—Not unlike a salesman, an attorney residing in the town of the debtor or prospective customer is favorably situated as a collector and distributor of credit information. His profession tends to bring him in close contact with the business and business men in his community. Like the salesman, he sees the subject in his setting, knows him personally, perhaps, and sees his place of business. Besides, an attorney invariably has a large circle of business and social acquaintances; this gives him an added advantage in the collection of credit data and opinions. Again, his daily routine in matters of litigation affords him an extensive field of information valuable from the standpoint of the credit grantor. Moreover, his special training often qualifies him to judge business conditions accurately.

Many concerns confine their practice of asking for attorney reports to towns of less than 15,000, on the theory that in the smaller communities an attorney's profession is more apt to bring him in personal contact with the business men in his locality—a feature that is considered essential to the making of reliable reports. In the large cities, however, many law firms have found this source of revenue sufficiently lucrative to warrant the installation of a special commercial department for the purpose of gathering, filing, and disseminating credit data relative to local firms. These attorneys also assist in collecting claims for out-of-town creditors against local debtors. This phase of their work will be discussed fully in a subsequent chapter.

Attorney Directories.—To aid in the selection of responsible attorneys, lists bearing the names and addresses of attorneys who have expressed a willingness to serve as collectors, and, incidentally, as credit reporters, are available for business houses, banks, and collection agencies. These lists are prepared by various publishing houses, which usually charge each attorney a small annual fee for representation. These lists are then placed in the hands of all houses and agencies likely to be interested. In many cases no charge is made for the lists thus

furnished, in which instances the publishing house relies entirely on the listing fees received from attorneys. In other instances, substantial charges are made for the lists and credit report forms which may accompany them.

In compiling attorneys' directories, the aim of the publishers is to secure in each community the names of one or more reputable attorneys from among those seeking commercial business. Due to the laxity respecting requirements for admission to the bar in some states, the selection of reputable attorneys is not always an easy task. If names of undesirable and inefficient attorneys appear on the list, however, they are apt to be weeded out in time, inasmuch as the practice followed in selecting attorneys for listings is to make little investigation at first but to eliminate all those names about which complaints are registered by business concerns. In this manner, comparatively good lists are made available by publishing houses whose experience in compiling attorneys' directories extends over a period of years.

Attorney Credit Reports.—For the most part, the information secured from attorneys parallels that obtained from salesmen, with the exception of two items. These are:

1. Claims and Lawsuits.—It is a rather simple matter for an attorney to obtain knowledge of lawsuits instituted against a subject, and, once obtained, to follow the progress and outcome of such action. Court records are available to this end and in most communities all proceedings are published daily and distributed among those concerned with legal matters. Then, too, the attorney is often called upon to represent other selling houses in the collection of claims against the subject of the inquiry.

2. Status of Subject's Real Property.—Many attorneys are thoroughly acquainted with property values in their respective communities. Some of them are experts in this respect. Hence the valuation submitted in this manner can be used by the credit grantor in checking the figures presented by mercantile agencies or the merchant himself. Furthermore, attorneys can easily and accurately ascertain from the usual records the encumbrances placed on the real property of the subject.

In regard to the other items, the local attorney is inferior in some respects and superior in others. Although it is relatively easy for the average attorney to know whether or not a business is located in or near the shopping district, few of them possess

a knowledge of the various factors determining a good location. What serves as an ideal location for one kind of business is not necessarily favorable for another. A keen analysis of all location factors calls for special training in merchandising, in which the average attorney is totally lacking. Similarly, the average lawyer is barely familiar with merchandising methods and policies and is, therefore, no more competent to pass judgment regarding the condition of the store, buying habits, and value of the stock on hand than a casual observer. The average salesman is much better fitted to serve in this capacity.

On the other hand, the average attorney, because of his associations with other merchants in his community, is able to secure opinions regarding the business ability of the subject and is particularly valuable in giving information on habits and local reputation. The attorney frequently knows the personal and family history of local merchants either through personal contact or through his wide circle of acquaintances and his information on these points is more valuable, particularly in smaller towns and cities, than that obtained through salesmen.

Value of Attorney Credit Reports.—Opinions differ among the larger concerns concerning the value of attorneys' reports. Some firms have used them successfully for a period of years and are, consequently, staunch supporters of the system; others use them sparingly. It is obvious, nevertheless, that, not unlike the value of a salesman's credit report, the attorney's credit data depend upon his ability to size up a situation properly, inasmuch as a large part of the report consists of mere opinions. Another factor is the willingness or diligence with which the investigation is conducted. On the whole, a report submitted by an average attorney is far less dependable than that of an average salesman. Several reasons are advanced in explanation of the statement. To begin with, the attorney may be a friend of the subject under investigation, which is perfectly plausible in smaller towns and cities, and thus renders no unfavorable report, especially in a matter of mere opinion, or hearsay. A second reason accounting for the difference in the quality of reports of salesmen and attorneys, respectively, is the prejudice on part of the latter against outside creditors. Reports may be colored in favor of local merchants without at the same time completely disregarding the truth. This criticism appears to be well grounded in isolated cases in small communities. Outside of extremely provincial

districts, the broadmindedness of attorneys seldom permits of such unfair discrimination. A third cause for the inferiority of attorneys' reports is the difference in credit standards of the house requesting a report and of the attorney rendering it, and hence, possibilities for misinterpreting opinions; whereas a salesman supposedly measures risks by the standards of his house, with which he should become intimately acquainted.

In the fourth place, many attorneys do not give the matter adequate attention because of the subordinate nature of the work. Unless he specializes in commercial work, he is apt to consider the work of collecting claims and reporting on risks as incidental to his main practice. Another and in many instances the most important reason lies in the inadequacy of the compensation for the service rendered. The immediate remuneration is seldom commensurate with the amount of work involved in compiling a report and is, therefore, not conducive to thorough investigations and substantiation of opinion.

In opposition to these criticisms, many houses contend that, notwithstanding his local friendly relation, the attorney specializing in commercial business can be relied upon for accuracy and completeness of statements, for, prompted by selfish motives, he is more anxious to furnish reliable information in order to gain the good will of the house making the inquiry, and thereby gain its collection business. The commission earned from collection work is more than sufficient to compensate the attorney for the effort expended in making a thorough investigation. Hence, many of the larger firms employ attorneys as trained credit investigators who have developed a highly efficient system for recording the data assembled. Reports rendered by these firms are necessarily very reliable.

To improve the character of the service, forms are furnished by publishers of attorneys' lists. The fewer the questions contained in the form, the more quickly the reply will be made to an inquiry, and the higher the quality of the answers. Sometimes the attorney may even ignore the specific questions of the form, substituting for the detailed answers the phrase, "good for the amount named," meaning thereby that the risk's credit standing is good beyond the shadow of a doubt. Should information be needed only on one or two points, however, a letter instead of a form will probably prove more efficacious.

Methods of Compensation.—Attorneys furnishing credit reports are paid either directly and immediately a small fee, usually $1 for each report, or indirectly by the promise of, in return, whatever collection business the house may have in a given locality. As long as the inquiring house has some collections in the locality where the attorney is situated, the latter method of compensation is probably the most satisfactory, provided the claims are actually handed over in accordance with the promise made. When few collections are sent at long intervals, however, attorneys will be found loath to answer many inquiries. Still worse, the free report system is subject to much abuse and many houses have taken advantage of the opportunity of securing gratis numerous reports from several attorneys in a given town, in return promising each whatever collection business it will have in his town. Obviously, the collections in any given community for one house can hardly be handled by more than one lawyer. Attorneys in some instances, by comparing notes, have discovered these flagrant abuses on the part of some unscrupulous credit men and have, therefore, refused to reply to inquiries or else have given offhand opinions without attempting to substantiate them. Consequently, the reports were worth no more than the price paid for them. These abuses also led to the adoption by some bar associations of a schedule of fixed rates for reporting services rendered.

Unless the attorney is actually engaged in making collections for the inquiring firm, it is by far more effectual to compensate him directly and in advance by enclosing a fee, when requesting an investigation, commensurate with the effort involved in the process.

Banks as Credit Reporters.—Though freely used, it is claimed that banks do not constitute a satisfactory source of credit information. A general and widespread prejudice formerly prevailed against bank reports. Although still existing in some quarters, it no longer prevails generally. In explanation of the inadequate and unsatisfactory reports said to be submitted by banks, several reasons have been suggested. One is that credit inquiries are handled by banks, purely as an accommodation, by a force of untrained and subordinate clerks and that it is not one of the purposes underlying the establishment of the institution. Fortunately this situation no longer obtains, at least in the larger banking houses. It is now widely recognized in banking

circles that one of the four principal functions of a bank's credit department is to furnish information to mercantile houses in reply to inquiries. Banks generally recognize the interdependence of mercantile and banking credits. If a debtor's credit becomes impaired with his selling houses, so as to preclude the possibility of obtaining merchandise on credit, his ability to meet his obligations at the bank would probably be seriously affected, and *vice versa*. Bankers, therefore, realize the importance of acquiring knowledge concerning borrowers from mercantile houses from which their principal purchases are made. To do this and induce merchants to answer inquiries fully and with frankness, they find it necessary to reciprocate. Banks now increasingly appreciate the exchange of credit experiences.

A second cause responsible for the supposed insufficiency of bank reports is based on the belief that the bank would make a flattering report regardless of the actual circumstances of the party inquired about, provided this party is the bank's debtor. The purpose of the report, it is believed, is to induce the extension of credit accommodations on the part of mercantile houses, thereby facilitating payment of the loan to the bank to the detriment of mercantile creditors. If we are at all to judge the attitude of bankers by past experience, the reasoning thus presented lies purely in the realm of class-room philosophy. In practice, the majority of bankers assume a business-like attitude toward matters of this sort.

Nevertheless, banks do not furnish the detailed information that mercantile creditors supply on request. The number of reports containing merely the bank's favorite and conventional expression, "We believe the man honest and good for his needs," is altogether too large. In explanation of this reluctance to give complete and frank reports, the following reasons may be advanced:

1. Because of their strictly confidential relations with borrowers, banks may obtain private information which they deem inadvisable to pass on to merchandise creditors, lest the confidence be violated.

2. Owing to a conservative policy, banks may receive, for greater safety required in their case, guarantees, indorsements, or collateral as security, which, if divulged to merchandise creditors, might be misinterpreted, to the detriment of the debtor. It may also be said in this connection that in the case of secured

loans banks are likely to possess less information than selling houses which run greater hazards. Because of the lack of tangible security, merchandise creditors are compelled to exercise closer supervision over their accounts, resulting in a more intimate knowledge of their risks than in the case of a bank, which holds the debtor's security for its loan.

3. Banks point out the fact that merchandise creditors do not need so much detailed information as the banks do, because

(*a*) Merchandise creditors work on a larger margin of profit than that on which banks operate and can, therefore, take greater risks.

(*b*) Merchandise creditors extend smaller amounts of credit than banks do to any given debtor. Merchants deal in smaller units.

(*c*) At any one time a debtor owes a merchandise creditor much less than he owes the bank; hence the hazard is smaller.

(*d*) Since merchandise creditors lend their own funds, whereas banks lend funds entrusted to them by depositors, acting in a fiduciary capacity, more care and caution must be exercised on part of the latter; hence the need for detailed credit data.

Notwithstanding all of these arguments, it appears reasonable to expect banks to furnish more complete data than a mere conventional expression, if the reciprocal advantages arising from interchange of credit information are to be fully enjoyed by all parties concerned. It may be said with justice that much improvement is to be noted in this direction. Occasionally, a charge of 25 cents, to be paid in advance, may be made for each report. This practice, however, is rather limited to small-town banks which do not expect ever to obtain the advantages of reciprocity with inquiring merchants from distant cities. This charge also prevents a promiscuous use of inquiries from banks. On the whole, it may be said that the old customs that have grown up in the banking business are being gradually sloughed off as modern business-like views and methods are adopted. A constantly growing number of banks now have highly developed credit departments which are charged with the duty of supplying mercantile houses with definite and complete information concerning depositors and borrowing accounts.

Bank Credit Reports.—In requesting information from a bank, the credit manager should be careful to obtain the correct name of the bank, and the particular branch, if any, with which

the customer does business, together with the exact name under which the account is kept. The last-mentioned item is of especial importance in connection with personal accounts affecting retail credit. Either letters or forms can be advantageously employed by the inquiring party. The advantage of an inquiry blank over a letter consists primarily in the convenience both in making and in replying to inquiries, and in the reduction of labor to a minimum.

No matter which method is employed, the following points are usually covered in a bank's credit report:

1. The length of the account.
2. The approximate amount of the customer's funds on deposit at the bank. Usually these balances are said to be large, medium, or small. The bank's idea of the size of its accounts in such instances depends largely on its own size and on the kind of business it transacts. What is considered small for a large bank may, indeed, be large for a smaller institution, and *vice versa*. Again, a balance that may be considered small for a large business firm's account would undoubtedly be large in the case of a personal account.
3. Amounts of loans extended by the bank to the customer under investigation.
4. The promptness with which the customer meets his obligations at the bank.
5. Whether the account is in funds when checks are presented.
6. Whether many drafts are presented to the customer through the bank and whether they are honored.
7. General reputation of the customer and whether the bank considers him reliable and worthy of credit.

Interpretation of Bank Reports.—When a bank replies that an account is small, fair, large, medium, or liberal, the inquiring party, in order to interpret the characterization properly, must know something of the size of the bank and the character of the account as already indicated in another connection. The word "liberal" is rather vague, but when used is considered complimentary to the depositor; when a bank says of its borrower "good for moderate credit," it means that limited credit is permissible. "Good for reasonable credit" indicates some confidence in the account, but bears watching. The expression "good for his requirements" usually indicates that the customer is

willing and able to take care of whatever he asks and that he is not likely to ask for credit beyond a reasonable amount.

The items in the bank's report concerning cash balances maintained by the customer and notes payable to banks constitute another mode by which to gage the subject under consideration. Both of these items may be used effectively to verify similar items appearing on the financial statement submitted by the applicant. Finally, it should be borne in mind that much valuable information can be obtained by cultivating a knack for reading between the lines of a bank's report.

SELECTED REFERENCES

ETTINGER, R. P., and GOLIEB, D. E.: "Credits and Collections," chap. 10.

CHAPTER XII

THE CREDIT RISK AND MISCELLANEOUS SOURCES

THE PERSONAL INTERVIEW

In order to draw the line sharply between the desirable and non-acceptable risks, more than a superficial knowledge of each customer is required. Much information can be gained from the various sources already treated in previous chapters. Notwithstanding the abundance of data obtainable through these sources, it is frequently desirable to establish and maintain a certain degree of personal contact with the trade.

Interviewing Customer in Office of Selling Firm.—Frequently when a merchant is seeking a line of credit, he or his representative will visit the credit manager with a view toward establishing satisfactory arrangements with him. Here is an invaluable opportunity of which no credit manager can afford not to avail himself fully. By assuming a friendly attitude rather than that of a cross-examiner, he may lead the prospective customer to express himself on market conditions, general trend of prices, styles, and other factors directly affecting his particular line of trade. It should be the aim of the credit manager so to steer the conversation during such an interview as readily to reveal the degree of prudence, judgment, and system exercised in anticipating the demand of his clientele and in the general operation of his business. He will thus discover whether the applicant is a shrewd buyer and so selects his goods as to insure their salability, or whether he is uninformed and buys injudiciously and indiscriminately, in which case he is apt to overstock with a poorly selected line of goods. Once taken into the credit manager's confidence by an attitude of friendliness and candor, the applicant will talk frankly and freely, thereby revealing facts in regard to his capital responsibility, organization, location, present circumstances, and prospects of his business enterprise.

To avoid any possible resentment against having their credit questioned, it is the practice of many houses to ask out-of-town customers calling on the firm to meet "our Mr. Smith," instead of proposing to meet "our credit man." The credit manager not being mentioned, the customer may be under the impression that he is talking to the treasurer or auditor of the firm. He will thus converse frankly and freely, and incidentally give all the information that may be required. It should be borne in mind at all times that entering into details should be avoided during the first or any personal interview at the seller's office, for that sort of information can be secured through the usual channels. The chief object of an interview is to permit the credit manager to size up the risk; to form a personal impression of his character and business competency; to serve as a basis for future correspondence; and to enable him to interpret more skilfully the information contained in the reports of mercantile agencies and credit bureaus.

Interview at Customer's Place of Business.—In the case of large accounts which present difficult decisions, it is well worth while for the credit manager to visit the customer at his place of business. Although it is more or less difficult and, particularly in large establishments, well-nigh impossible to meet all the customers personally, it is nevertheless essential that the credit manager arrange periodically to make credit trips around his trade area, calling on those risks concerning whose credit responsibility he is seriously in doubt.

In visiting the customer's place of business, whether it be a retail establishment, a wholesale house, or a manufacturing plant, the credit man can acquire certain data which is not obtainable through any other channel. He can thus form a personal impression of the customer's methods of doing business, general proficiency, location, arrangement of stock, and many other factors. In addition to this, the credit manager has the invaluable opportunity of sizing up the risk, as to his character and business ability, probably to better advantage than when meeting him at the credit man's office, for here the man is seen in his setting, as he naturally appears from day to day, and is, therefore, likely to be devoid of all artificial and assumed characteristics.

Traveling Credit Representatives.—Some of the larger houses find it advantageous to employ credit department repre-

sentatives. These are allotted specific territories, the same as salesmen, which they are required to cover periodically with a view of inquiring into the credit standing of applicants and of such old customers as directed by the credit department. Most of the points covered by them in their investigations parallel those secured by traveling salesmen, save for the thoroughness with which the more qualified and better equipped credit specialist conducts his inquiries. In addition, these investigators inquire into the financial condition and other relevant factors determining the customer's debt-paying power.

It is needless to say that the scope of a given investigation and the degree of thoroughness to be exercised in its conduct vary considerably with the relative seriousness of the situation involved. If serious weaknesses are disclosed, the credit department representative may feel warranted in even examining the books of account. In other instances it may suffice to obtain the latest available statement of financial conditions or merely to discuss conditions in general. No set rule can be profitably laid down as a guide to a determination of the scope of such an investigation, since the extent of any inquiry will necessarily have to be governed by the circumstances of the particular case.

Many houses are at present adopting the policy of sending representatives to visit large accounts which involve some serious doubt or difficulties, even though no special traveling credit investigators are employed. The effect of such a visit may be to lead to a closer and friendlier relationship based on a better mutual understanding between buyer and seller and thus result in increased volume of business, or else it may lead to a decision involving the necessity of closing the account either immediately or gradually, and thereby avoid an otherwise inevitable loss.

MISCELLANEOUS SOURCES OF INFORMATION

Among the miscellaneous sources are to be listed corporation manuals and rating books, corporation cards and similar services, the "Credit Man's Diary," and trade and financial papers and magazines.

Corporation Manuals.—Concerns which deal with railroads, public utilities, or industrial corporations of some size will find important and valuable data in the manuals. The three most important and best known manuals are Poor's, Moody's, and the "Manual of Statistics." Although published primarily for

the benefit of banking institutions, brokerage houses, and individuals who invest in the securities of large corporations, the credit manager will nevertheless find them highly valuable from his standpoint as will be readily seen from their contents.

Poor's "Manual of Railroads" has been published since 1867. It comprises statements of all railroads in the United States and Canada and the principal railroads of Mexico, Cuba, and Central America. All roads are arranged alphabetically and in each instance the following points are contained: a detailed account of the company's mileage; its history or antecedents; the most recent available income account and comparative balance sheet; traffic statistics; capital expenditures; a detailed description of the corporate securities; a list of officers and directors; and the location of the general or main office.

The other two sections of Poor's and Moody's Manuals now appear in consolidated form, published by the Poor Publishing Company. One of these sections deals with industrial corporations, the other with public utilities. Both contain antecedents, extent of operations, the most recent available income account and single or comparative balance sheet, detailed description of the company's securities, its dividend record, and names of officers and directors.

The "Manual of Statistics," published by the Commercial Newspaper Company since about 1878, contains descriptions of leading corporations, including all essential financial and operating data. In addition, it contains information and statistics on railroads, coal, iron and steel, metal industries, cotton, grain and provision; also statistics on bank clearings and the money market.

For convenience to the user, the "Manual of Statistics" is divided into sections. All corporate descriptions are thus classified as industrial, mercantile, financial, public utilities, and transportation. The financial section includes investment and trading corporations. In the transportation section are included railroads, steamship companies, pipe lines, terminals, and express companies.

The contents of the "Manual of Statistics" differ somewhat from those of the other two manuals described. It includes antecedents, capitalization, complete dividend record, comparative condensed income account for several years so as to show a corporation's growth and earning power over a period of about

10 years wherever possible; also a comparative balance sheet, list of officers and directors, main office, and range of market prices of its securities, if listed on an important stock exchange, giving the high and low points for several years past. This manual, not unlike the others, is extremely useful as a medium for checking up a corporation's credit standing, and for determining the status of its securities.

Corporation Rating Books.—In addition to his manuals, John Moody has published since 1909 "Rating Books," in four parts or volumes. Part One deals with steam railroads; Part Two covers industrial investments; Part Three, public utility investments; and Part Four deals with Government and municipal investments. The section on industrials is particularly valuable to credit managers. It contains statements of practically all corporations of importance in which there is any investment interest whatever. In addition to the information contained in the manuals, it furnishes tables containing dividend and security price records and ratings, and amount of working capital. Where a complete analysis could not be presented because of an inadequacy in figures, all available facts are cited without any attempt to analyze them. One or more of these four volumes may be subscribed for at any given time.

The rating book service calls for monthly supplements of rating revisions and new ratings. Subscribers are also entitled to the bulletins of current earnings which are issued periodically. The rating books can be obtained at $20 each.

Corporation Cards and Other Services.—Some publishing houses issue information of substantial similarity to that contained in the manuals in card form. Thus, the Standard Statistics Company furnishes its subscribers two cards on each corporation, one containing practically the same information as the manuals, whereas the other includes data of a more recent character, such as monthly income accounts, current reports and rumors, of a material bearing, concerning the corporation in question. Accordingly, as new reports come out, new cards are issued. Some publishing houses also furnish a cabinet in which the cards are filed.

If a person does not desire the complete service, he may still obtain cards on individual corporations.

Services somewhat similar to that just described are also furnished by Babson, Brookmire, Prentice-Hall, Moody, and others.

Moody, for example, offers two kinds of services in addition to the rating book service, the Investment Inquiry Service and the Complete Reporting Service. The first gives the subscriber the privilege of submitting investment problems, personally or through correspondence, to Moody's, also to ask for information, opinion, or advice on any investment security or investment subject. Each subscriber to this service is also entitled to a weekly review of financial conditions issued by the company, a special analysis weekly of some particular corporation, a monthly analysis and barometer of business conditions, and letters and bulletins of interest issued at frequent intervals. The cost of the service amounts at present to $100 per annum.

Moody's Reporting Service is more complete and comprehensive and embraces a semi-annual audit or appraisal of the client's investment holdings. Bulletins of advice are also furnished clients voluntarily on the subjects which are of direct personal significance. This service also includes all the features of the Investment Inquiry Service. The cost of the reporting service depends upon the volume of work required of the house. Thus, if no more than 50 securities are to be audited or appraised semi-annually, $200 per annum will cover it.

Every credit man dealing with railroads, public utilities, or industrial corporations of some size should have at his command at least one of the services referred to, for important information can thus be obtained in convenient form. Nothing reflects more fully a corporation's status than its growth in earning capacity, dividend record and policy, and its comparative financial statement. All of these facts and many others are made readily available for the command of the alert and sophisticated credit grantor.

Trade and Financial Publications.—Much information of a general character may be secured by carefully reading one or more magazines on general business and financial conditions. A credit manager should also familiarize himself with trade publications, covering the lines in which he and his customers are interested. From them, items of interest respecting the trade of customers and the territories in which they operate can be discovered. These should be clipped, properly identified, dated, and filed. A thorough knowledge of economic and political conditions, particularly as applying to the trade of the risk or his location, constitutes an invaluable asset of which a credit

dispenser may well be proud. Skill in tapping these hidden sources of information at the right time is in no small measure responsible for the success of its possessor.

"Credit Man's Diary."—No credit manager's office is complete without this valuable annual publication of the National Association of Credit Men. The "Credit Man's Diary and Manual of Commercial Laws" is "a compendium of State and Federal Statutes, directly affecting the work of the credit man." It also contains memorandum pages for the days of the year. It is one of the greatest credit department facilities. Questions frequently arise in analyzing and checking credits which are quickly and explicitly answered by this publication; in a word, it is a handbook which no credit manager can afford to be without.

CHAPTER XIII

SECURING BUSINESS STATEMENTS AND THE LAW

In investigating a merchant's financial responsibility and business capacity, not less than two statements are commonly resorted to, namely, the financial or property statement, and the income or profit and loss statement. Because of negligence or unwillingness on the part of the giver, a complete profit and loss statement is seldom obtained by others than banking creditors, except when extraordinary occasions arise involving the shipment of unusually large orders or the extrication of the debtor from financial embarrassment. Nevertheless, it is interesting to note that practically all standard forms of so-called financial statements adopted by the National Association of Credit Men, mercantile agencies, and allied institutions, provide additional space for the filling in of certain profit and loss items without which no satisfactory analysis is possible. Technically, therefore, both statements are utilized as a basis for credit. Since any such improvement in terminology, however, is generally purchased beyond its value, because of the confusion arising from the conflicting associations in thought, it is deemed advisable to refer to this combination as the financial statement, property statement, or balance sheet. The difference between these three terms is essentially a technical one and depends upon whether the information is presented in the account or the report form, the term "balance sheet" technically referring to the former arrangement.

The Financial Statement.—In the interest of clearness, it may be well briefly to depict the business statements which constitute some of the important tools of the modern credit manager. A financial statement is but a photograph of the financial condition of a particular business at a given moment, setting forth in some classified manner its assets, liabilities, and net worth. It is a cross-section of a concern's financial standing at a given time. The information contained therein may be

presented in a general or detailed manner. Again, the statement may be condensed or consolidated, single or comparative.

The Profit and Loss Statement.—The income, or profit and loss, statement supplements the record shown by the financial statement by indicating the manner in which the net worth has been changed during the period covered. It may also be considered complementary to the other record because it helps to complete the story recorded therein. It shows the gross sales or income, a schedule of operating expense, the net income, annual and total surplus, or net profit for the year in case of partnerships and single proprietorships. The income statement reflects a dynamic condition, it is a moving picture, whereas the financial statement shows the condition of the business when at a temporary standstill.

Reasons for Statements.—In a credit transaction it is the right of one party to receive, and the duty of the other to give, information sufficient to enable the prospective creditor to form an intelligent opinion regarding the probable ability of the prospective debtor to discharge his obligations at maturity. Because of the present-day keen competition and attending close margins, successful business men do not extend credit accommodations without information which tends to disclose an applicant's financial responsibility with almost mathematical precision. Accordingly, from the standpoint of the credit grantor, a signed financial statement is extremely beneficial. It helps him to determine whether the risk has sufficient realizable assets in his business to warrant the belief in his ability to meet his obligations at maturity, if willing to do so. Knowing the exact financial condition of the customer, the credit grantor can exercise better judgment in fixing a credit limit and in the granting of requests for renewals and extensions. Furthermore, the incompetent risks are gradually weeded out, since they are generally unable to furnish satisfactory financial statements. Laxity on the part of credit grantors in requiring statements of such risks obviously leads to the perpetuation of such merchants in business to the detriment of the seller. Finally, creditors can frequently prevent dishonest debtors from committing frauds, if signed statements are demanded from which the exact situation may be ascertained. Laws have been enacted in many states making it a crime for a merchant to submit a false statement in writing for the purpose of obtaining

credit. Hence, the debtor who contemplates perpetrating a fraud will hesitate to issue a statement for fear of prosecution under these laws.

Many benefits equally inure to the giver of a financial statement. Reputation or character, although an extremely important factor in credit extensions, is nevertheless not the only factor. The giver of credit is a contributor of capital, and becomes, in a sense, a partner of the debtor, and, as such, has a perfect right to demand complete information of the debtor's business resources, at all times. Hence a merchant who desires to serve his own interests should recognize that, under the prevailing business conditions, the most effective way of proving his basis for credit is through his willingness to submit a statement of his financial condition.

One of the beneficial effects which the practice of requiring financial statements has on the debtor is derived from his realization of the necessity for making a good showing. Because of the material influence of the statement upon his credit standing, the debtor is forced to maintain his business in good condition, and prior to entering any hazardous undertaking he is apt to reflect on the probable effect of the outcome of such venture on the appearance of his balance sheet. A second advantage to the debtor lies in the necessity for keeping books of record. Incompetence is due in large measure not to lack of ability but to lack of information. Lack of information in the retail trade can hardly be due to anything but inferior bookkeeping methods. What they need most is accounts which actually account. Asking for a financial statement will encourage and stimulate better methods of accounting. Moreover, as already pointed out, the probable effect of the practice in requiring statements will be ultimately to weed out the incompetent traders to the benefit of the honest and capable merchants, thereby reducing competition to a sound basis. The incompetent merchant frequently offers the meanest sort of competition. When in need of funds, he is apt to undersell the honest and capable dealer, even when required to sell below costs. The inability of these traders to submit satisfactory statements will, through the consequent refusal of credit accommodations, tend toward their complete elimination from the field of business. Furthermore, an exact knowledge of a debtor's circumstances, as afforded by the statement of his financial con-

dition, results in the fixing of definite lines of credit which the creditor may prudently give and the debtor may prudently receive. The disaster to the buyer through accepting too much credit may be even greater than the disaster to the seller through giving too much credit. Statements are, therefore, protective to debtor and creditor alike. In addition they tend to establish confidence in the buyer, whose trade is on that account solicited by the best houses.

Methods of Obtaining Statements.—Financial statements may be obtained direct from the merchant or indirectly through mercantile agencies, interchange bureaus, and trade credit offices. Probably the largest number of creditors rely on the statements obtained through the indirect method. Statements coming through these sources are often incomplete and consequently cannot be used as a basis for careful and intelligent analysis and interpretation. It is also claimed that many statements are secured orally by the agency's reporters, due to the reluctance of many debtors to fill out the forms submitted by the agency. Statements so compiled are practically valueless and sometimes even worse than none, on account of the extreme inaccuracies which may creep in. Then, too, the financial statements in the agency reports are sometimes entirely too old. Much improvement in this direction is to be noted, however.

In view of the foregoing, it is obvious that, if complete and otherwise satisfactory statements are to be secured, a request should be made by the creditor direct. The effect is both salutary and efficacious. In case a merchant is called upon to fill out a form furnished by his creditor, much greater care and caution will undoubtedly be exercised in compiling the data.

In spite of the disadvantages incident to the indirect mode of obtaining statements, relatively few creditors resort to the direct method, except when in doubt as to the debtor's standing and when the statements secured from indirect sources prove unsatisfactory and inadequate. Some houses, including banks, generally follow the practice of requiring statements from all new credit seekers. Other concerns require statements from all or most of their debtors at regular intervals, usually, every year. This practice serves to impress the debtor with the vigilance of his creditors, thereby inducing him to measure up to their higher credit standards.

Forms of Statements.—Several forms adapted to different lines of business have been adopted and recommended by the

"Large assets are not always necessary to the creation of credit, what is most desirable is, that credit be in relative proportion to the actual assets."

PROPERTY STATEMENT
TO

"The giver of credit is a contributor of capital, and becomes, in a certain sense, a partner of the debtor, and, as such, has a natural right to complete information of the debtor's condition at all times."

Form Adopted and Recommended by the National Association of Credit Men

For the purpose of obtaining merchandise from you on credit, we (I) make the following statement in writing, intending that you should rely thereon respecting our (my) financial condition as of (Date)_____ 19___

(All questions should be answered. When no figures are inserted, write word "None.")

ASSETS			LIABILITIES		
Cash in hand			For MERCHANDISE:		
Cash in bank			Accounts owing not due		
Accounts owing by customers, good and collectible, not pledged or sold			Accounts owing past due		
Notes owing by customers, good and collectible, not pledged or sold			Trade Acceptances payable		
Trade Acceptances receivable, not pledged or sold			Notes payable for Mdse.		
Merchandise: (not on consignment or conditional sale.) (How valued; Cost_____ Market_____)			For BORROWED MONEY:		
			Notes payable to banks		
Other quick assets:			Notes or debts payable to others (including relatives and friends)		
(Describe)			Deposits of money with us. (Describe)		
			Owing for Wages and Salaries		
			Owing for Taxes (city, state and federal)		
			Owing for Rental		
			Owing for Insurance Premiums		
TOTAL QUICK ASSETS			TOTAL QUICK LIABILITIES		
Machinery: (How valued; Cost_____ Depreciated_____)			Debt secured by mortgage on land or buildings		
Fixtures and other Equipment. (How valued; Cost_____ Depreciated_____)			Debt secured by chattel mortgage or other liens		
Land and Buildings as described below			Debt secured by judgment		
			Other liabilities:		
Notes and Accounts owing from officers, employees, or others not customers			(Describe)		
Other assets:					
(Describe)					
			TOTAL LIABILITIES		
			NET WORTH		
TOTAL ASSETS			TOTAL		

What books of account do you keep? _____

Was this statement made from those books?_____ Do you keep cost records?_____

Do you sell or pledge your accounts to creditors, banks, finance companies or others?_____. If so, what amount is so sold or pledged? $_____What amount of your accounts have you sold or pledged during the past twelve months? $_____

Are any creditors secured by mortgage or lien of any sort?_____ If so, how?_____

Are any claims in attorneys' hands or suits against you?_____

Have you merchandise on consignment or conditional sale?_____ If so, what amount? $_____

If business property is leased, for what term and what rental?_____

Name and locality of your bank or banks_____

Location and kind of business_____

Previous business experience_____Where_____

It is important that every question on both sides of this sheet be correctly answered and that the blanks be carefully filled in. In answering questions involving amounts write the word "none" where figures do not apply. You will find it advantageous to keep a copy of this statement for comparison with the showing you will be able to make a year hence.

FIG. 28.—Form of financial statement adopted and recommended by the National Association of Credit Men.

National Association of Credit Men, which are widely used, particularly by the smaller concerns (see Figs. 28 and 29).

Practically all of the larger houses have, as a rule, their own special form of financial statement, drawn up in accordance with

INSURANCE

On Merchandise $_____ On Buildings $_____ Machinery $_____ Fixtures $_____

Other Equipment $_____ Employers' liability $_____

Is any insurance assigned?_____ What amount?_____ To whom?_____

Amount of life insurance for benefit of business $_____

With what companies_____

SUMMARY OF PROFIT AND LOSS

Inventory of Mdse. beginning of fiscal year (not including fixtures or equipment)			Sales last fiscal year		
			Income from all other sources		
Cost of Mdse. purchased during the year			Inventory of Mdse. at close of year		
General expenses including salaries, losses, etc.			Total Income for year		
			Less Total Expenses		
TOTAL EXPENSES			NET PROFIT FOR YEAR		

RECORD OF LAND AND BUILDINGS

Title in name of	Description and location	Book value	Assessed value	Amount of Encumbrances	To whom

BUY PRINCIPALLY FROM THE FOLLOWING CONCERNS

Names	Addresses	Amount Owing	
		Open Account	Notes

Names and Addresses of Owners of Business _____

REMARKS:

The foregoing statement has been carefully read (both printed and written matter) and is in all respects complete, accurate and truthful. It discloses to you the true state of our (my) financial condition on the date above stated. Since that time there has been no material unfavorable change in our (my) financial condition; and if any such change takes place we (I) will give you notice. Until such notice is given, you are to regard this as a continuing statement.

Firm Name_____

Signed by_____

Street_____ Town_____ State_____

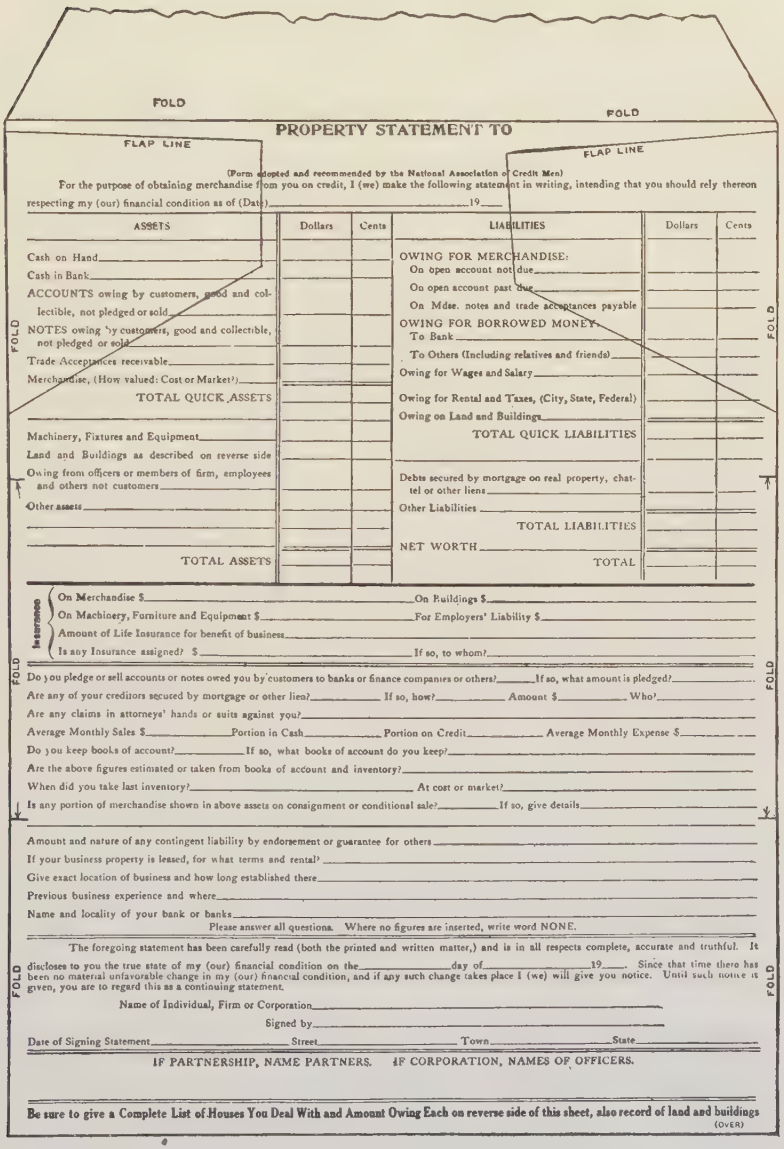
Date of signing statement_____ 19____

Form R.

FIG. 28 B.—Reverse side of Fig. 28 A.

their requirements, although most of them follow the standard forms recommended by the National Association of Credit Men.

An examination of a large number of forms used by houses



FOLD FOLD

PROPERTY STATEMENT TO

FLAP LINE FLAP LINE

(Form adopted and recommended by the National Association of Credit Men)

For the purpose of obtaining merchandise from you on credit, I (we) make the following statement in writing, intending that you should rely thereon respecting my (our) financial condition as of (Date)_____ 19____

ASSETS	Dollars	Cents	LIABILITIES	Dollars	Cents
Cash on Hand			OWING FOR MERCHANDISE:		
Cash in Bank			On open account not due		
ACCOUNTS owing by customers, good and collectible, not pledged or sold			On open account past due		
NOTES owing by customers, good and collectible, not pledged or sold			On Mdse. notes and trade acceptances payable		
Trade Acceptances receivable			OWING FOR BORROWED MONEY: To Bank		
Merchandise, (How valued: Cost or Market?)			To Others (Including relatives and friends)		
TOTAL QUICK ASSETS			Owing for Wages and Salary		
Machinery, Fixtures and Equipment			Owing for Rental and Taxes, (City, State, Federal)		
Land and Buildings as described on reverse side			Owing on Land and Buildings		
Owing from officers or members of firm, employees and others not customers			TOTAL QUICK LIABILITIES		
Other assets			Debts secured by mortgage on real property, chattel or other liens		
			Other Liabilities		
			TOTAL LIABILITIES		
TOTAL ASSETS			NET WORTH		
			TOTAL		

FOLD FOLD

Insurances

On Merchandise $_____ On Buildings $_____

On Machinery, Furniture and Equipment $_____ For Employers' Liability $_____

Amount of Life Insurance for benefit of business_____

Is any Insurance assigned? $_____ If so, to whom?_____

Do you pledge or sell accounts or notes owed you by customers to banks or finance companies or others?_____ If so, what amount is pledged?_____

Are any of your creditors secured by mortgage or other lien?_____ If so, how?_____ Amount $_____ Who?_____

Are any claims in attorneys' hands or suits against you?_____

Average Monthly Sales $_____ Portion in Cash_____ Portion on Credit_____ Average Monthly Expense $_____

Do you keep books of account?_____ If so, what books of account do you keep?_____

Are the above figures estimated or taken from books of account and inventory?_____

When did you take last inventory?_____ At cost or market?_____

Is any portion of merchandise shown in above assets on consignment or conditional sale?_____ If so, give details_____

Amount and nature of any contingent liability by endorsement or guarantee for others_____

If your business property is leased, for what terms and rental?_____

Give exact location of business and how long established there_____

Previous business experience and where_____

Name and locality of your bank or banks_____

Please answer all questions. Where no figures are inserted, write word NONE.

The foregoing statement has been carefully read (both the printed and written matter,) and is in all respects complete, accurate and truthful. It discloses to you the true state of my (our) financial condition on the____ day of____ 19____. Since that time there has been no material unfavorable change in my (our) financial condition, and if any such change takes place I (we) will give you notice. Until such notice is given, you are to regard this as a continuing statement.

FOLD FOLD

Name of Individual, Firm or Corporation_____

Signed by_____

Date of Signing Statement_____ Street_____ Town_____ State_____

IF PARTNERSHIP, NAME PARTNERS. IF CORPORATION, NAMES OF OFFICERS.

Be sure to give a Complete List of Houses You Deal With and Amount Owing Each on reverse side of this sheet, also record of land and buildings

(OVER)

FIG. 29.—"Env-o-blank" form of financial statement adopted and recommended by the National Association of Credit Men and very commonly used.

operating on a substantial scale reflects a special effort on their part to simplify the form so as to contain only the most important items. Experience has shown that many merchants are discouraged at the outset and either refuse entirely to submit a statement or else omit many points if the form they are required to fill out is too intricate and burdened with all sorts of details. Many houses have, therefore, concluded that it is possible to ask for too much information and have simplified their forms accordingly so as not to make them too comprehensive but to cover merely the essential and vital points.

False Statement Legislation.—The financial statement as a basis for credit extensions is now thoroughly established in the business world. With the tremendous development of its use, the next natural step is to safeguard and protect it against unscrupulous individuals who would issue a false statement for the purpose of securing credit. A false statement may be defined as one which conveys the impression that the financial condition of the enterprise is otherwise than it is in reality. This is usually accomplished by overestimating the value of the assets, omitting liabilities, or improperly classifying them so as to place, for example, a liability among the assets.

The Federal law, Section 215 of the U. S. Criminal Code, provides:

> Whoever, having devised or intending to devise any scheme or article to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, etc., shall for the purpose of executing such schemes or artifice, or attempting so to do, place, or cause to be placed, any letter, postal card, package, writing, circular, pamphlet, or advertisement, whether addressed to any person residing within or outside the United States, in any postoffice, or station thereof, or street or other letter box of the United States, or authorized depository for mail matter, to be sent or delivered by the Post Office establishment of the United States, or shall take or receive any such therefrom, whether mailed within or without the United States, or shall knowingly cause to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such letter, postal card, package, writing, circular, pamphlet, or advertisement, shall be fined not more than one thousand dollars, or imprisoned not more than five years or both.

To secure a conviction under this law it is thus necessary to prove:

1. That the debtor issued a false statement in writing.
2. That he obtained money or property on credit on the basis of the statement.
3. That the statement was sent through the mails.

Consequently, all the envelopes in which the financial statements are received should be carefully preserved after having been dated and signed by the party receiving the statement and by a responsible witness to the effect that the signed envelope contained the financial statement in question. This precaution proves of great value in offering reliable testimony to the effect that the mail was used to defraud. Obviously, the envelope must be permanently attached to the statement itself, which is clumsy and inconvenient. Houses following the practice of preserving envelopes containing statements will, therefore, find it to their advantage to utilize one of the combined statement forms and mailing envelopes adopted and recommended by the National Association of Credit Men.

The advantage of the Federal law is that it imposes more severe punishment on fraudulent debtors than do the state laws. On the other hand, the law is too inadequate, for it covers only cases where the mails have been used as a means of transmitting false statements for the purpose of securing credit. It does not, therefore, apply to numerous instances involving the submission of false statements in person in connection with interstate transactions, and, in spite of the existence of false statement laws in the states involved, it is impossible to bring such cases within the provisions thereof, since the False Statement Law of the several states apply only to intrastate credit transactions.

State Laws.—The rapid development and increased use of financial statements as a basis for credit necessitated still further protection than that afforded by the Federal law. Although nearly every state has some form of statute providing for the punishment of offenders, who, by means of false pretenses or representations secure credit, such statutes have fallen short in numerous instances where fraudulent acts have been committed in connection with the issue of false statements of financial condition. In view of this fact, over 30 states have already enacted some form of special statute for the punishment

of offenders, who would not otherwise come within the provisions of the preexisting laws.

The New York statute, passed in 1912, is considered the model state False Statement Law and has been copied practically verbatim in many other states. The law is broad enough in scope to cover all cases involving the making of false written statements for the purpose of obtaining credit in any form, including cases where such statements are made direct to the creditor or indirectly through the commercial agencies, brokerage houses, and the like, whose intention it is to communicate them to such persons or firms as may have occasion to consider entering into credit transactions with the maker of the statement. Moreover, the law aims at the person who makes the statement or causes it to be made, irrespective of whether credit is thereby sought for his own benefit or for that of any other person, firm, or corporation.

The New York law given herewith in full provides that any person:

1. Who shall knowingly make or cause to be made, either directly or indirectly, or through any agency whatsoever, any false statement in writing, with intent that it shall be relied upon, respecting the financial condition, or means or ability to pay, of himself, or any other person, firm or corporation, in whom he is interested, or for whom he is acting, for the purpose of procuring in any form whatsoever, either the delivery of personal property, the payment of cash, the making of a loan or credit, the extension of a credit, the discount of an account receivable, or the making, acceptance, discount, sale or indorsement of a bill of exchange or promissory note, for the benefit of either himself or of such person, firm or corporation; or,

2. Who, knowing that a false statement in writing has been made, respecting the financial condition, or means, or ability to pay, of himself, or such person, firm or corporation in which he is interested, or for whom he is acting, procures, upon the faith thereof, for the benefit either of himself, or of such person, firm or corporation, either or any of the things of benefit mentioned in subdivision one of this section; or,

3. Who, knowing that a statement in writing has been made, respecting the financial condition, or means, or ability to pay of himself or such person, firm or corporation, in which he is interested, or for whom he is acting, represents on a latter day, either orally or in writing, that such statements theretofore made, if then again made on said day, would be then true, when in fact, said statement if then made would be false, and procures upon the faith thereof, for the benefit either of himself

or of such person, firm or corporation, either or any of the things of benefit mentioned in subdivision one of this section,

Shall be guilty of a misdemeanor and punishable by imprisonment for not more than one year or by a fine of not more than one thousand dollars, or both fine and imprisonment.

As may be observed from the statute, the law seeks to punish the mere making of a false statement in writing "with intent that it shall be relied upon." Obviously, a statement may be false without being fraudulent. It may be exaggerated for the purpose of obtaining credit and ultimately paying for the property thus secured, and not with a view of defrauding the creditor. In spite of innocent intent, the statement is nevertheless false and the law makes it a crime and misdemeanor, by applying the same principle which makes the carrying of concealed weapons a crime. It is the prevention of the possession of instruments of crime that deters the commission of the real crime.

The law also seeks to punish any person procuring credit on the basis of a false statement irrespective of whether or not he is the maker of it.

Where statutes similar to that described have been enacted, the only elements of proof required against the defendant are:

1. That he made the statement.
2. That the statement is false.
3. That he made it with intent that it should be relied upon.
4. That he made it for the purpose of procuring credit in any form whatever.

Prior to the enactment of such statutes the following elements of proof were required against the defendant in most states, in order to bring his act within the provisions of the law:

1. That he made fraudulent or false representations or pretenses.
2. That he intended to deprive or defraud the creditor of his property.
3. That he actually obtained the property.

From the foregoing it appears that it would be quite difficult to obtain convictions under such law. Aside from the proof as to the falsity of the pretences, further proof is required to the effect that the person who was defrauded relied upon the statement and that the money or property was actually delivered to the defendant. The old law also permitted a mer-

chant to exaggerate his statement of financial condition, unless he had the intention to defraud the creditors who relied upon it in their credit relations—an intangible item next to impossible to prove. All of these defects are obviated by the newer statutes which follow that of New York.

Representative of another group of states in relation to false statements is the statute of Ohio, which provides that:

> Whoever knowingly makes or causes to be made, either directly or indirectly, or through any agency whatsoever, any false statement in writing, with intent that it shall be relied upon, or knowing that a false statement in writing has been made by another with such intent, respecting the financial condition, property, indebtedness, means, or ability to pay, of himself, or any other person, firm or corporation, in whom or which he is interested or for whom or which he is acting, and upon the faith thereof he or some other person acting for or in collusion with him or with his knowledge procures in any form whatsoever, either the delivery of personal property, or chose in action, the payment of money, the making of a loan or credit, the extension of a credit, the discount of an account receivable, or the making, acceptance, discount or endorsement of a bill of exchange, promissory note, or other commercial paper either for the benefit of himself or such person, firm or corporation, shall, if the value of the thing or amount of the loan, credit or benefit procured is thirty-five dollars or more, be deemed guilty of a felony, and be fined not more than one thousand dollars or imprisoned in the Ohio penitentiary not more than six years, or both, or if the value of less than that sum, be guilty of a misdemeanor, and be fined not more than one hundred dollars or imprisoned in the county jail or workhouse not more than six months or both.

SELECTED REFERENCES

Brewster, S. F.: "Legal Aspects of Credit," Pt. III, pp. 114–123.
Ettinger, R. P., and Golieb, D. E.: "Credits and Collections," chap. 12.
McAdow, F. H.: "Mercantile Credits," chaps. 7 and 8.
Wall, A.: "Analytical Credits," chap. 6.

CHAPTER XIV

CONSTRUCTION AND VALUATION OF FINANCIAL STATEMENT

When carefully prepared and skilfully analyzed, financial statements offer the credit manager an unusually satisfactory source of information. The experienced analyst can obtain from them numerous important facts which are not available from any other source.

Arrangement.—All financial statements may be said to consist of assets and equities. Equities are, in practice, divided into liabilities or claims against the business held by outsiders, and proprietorship, or residual claims against the enterprise on the part of its owners, or stockholders.

All assets naturally fall into three groups, depending upon the manner in which they function within the business enterprise:

1. Current or "quick" assets comprise those properties which are readily converted into cash and made available for the purpose of discharging primarily current liabilities incurred in the operation of a business. This class of assets consists of cash, notes receivable, acceptances, accounts receivable, merchandise inventories, investments easily convertible into cash, and the like. Current assets are sometimes further divided into "quick" and "slow," in which case the latter term is used to denote all those assets which are past due or which cannot be quite as readily converted into cash. Usually, however, the term "current" and "quick" are used interchangeably.

2. Deferred assets, commonly termed "deferred charges," consist of items, such as interest, taxes, insurance premiums, and other payments made in advance. This group contains all credits which have been secured as a result of payments made for the benefit of subsequent accounting periods.

3. Fixed assets constitute the third class. These are of a permanent nature, since they are not subject to radical changes within short periods of time. Land, buildings, equipment, ma-

chinery, fixtures, good will, patents, and trade-marks exemplify this class of properties.

All liabilities are distinguished in analogous fashion between what constitute current, deferred, and fixed obligations.

1. Current liabilities are those which mature in the immediate future and must be paid promptly, usually out of current assets, such as accounts payable, notes payable and dividends already declared but unpaid.

2. Deferred liabilities consist of all expenses that have been incurred during the period covered by the statement but the payment of which has been postponed to the accounting period following. They include all accrued items, such as wages due but unpaid, accrued rent, accrued taxes, etc.

3. Fixed liabilities consist of obligations which do not mature for a considerable time, usually not less than a year from date of statement. This class includes all real and chattel mortgages, promissory notes maturing at a relatively distant future, and all kinds of bonded obligations.

CONTENTS AND VALUATION OF ASSETS

As a precautionary measure, credit grantors deem it necessary not only to ascertain the correctness of the items listed on the assets side of the balance sheet, but also consider prudent a policy which calls for "shading the assets," or writing off a certain percentage. Some intangible items, such as good will, patents, or trade-marks, are occasionally deemed worthless and are, therefore, entirely disregarded. This policy is based on the assumption that the maker of a statement, for the purpose of procuring credit, by endeavoring to make a favorable showing, will be prone to list his assets at their highest possible value, which may not at all represent the actual sum which will in all probability be realized ultimately. The amount to which the assets are "shaded" or "shaved down" is obviously contingent upon the kind of business represented by the statement, the nature of the constituent items, and the individual judgment of the credit manager as determined by the degree of his knowledge.

Cash.—This item should comprise the total of cash on hand and in bank, provided the latter is subject to immediate withdrawal. It should not include I O U's, since their collectibility is frequently doubtful; unexpended balances in the hands of

salesmen, which are not to be returned as cash to the business; nor should cash include funds subject to liens, or those which are otherwise tied up so as not to be available immediately for payment of debts. In this connection it is important to remember that in case the maker is indebted to the bank in which his funds are deposited, the bank has a lien against the deposit to the extent of the sum loaned. For this reason it is advisable to have the cash on hand and that on deposit in the bank listed separately.

Another purpose served in separating the two items is the facility which it offers in arriving at conclusions concerning the probable contents of the cash item. Thus, if the cash on hand seems unusually large in amount, it may be reasonably inferred that it contains I O U's and other items the inclusion of which is forbidden by sound theory and practice. It should be remembered in this connection that no set rule can be laid down regarding the amount of cash a statement should show, since it is an item which materially varies in size with different types of business and at different seasons. Credit grantors usually prefer to see 10 to 20 cents cash for every dollar of current indebtedness. If the amount is particularly small, namely, below the former figure, it might indicate lack of working capital and failure to maintain the 20 per cent balance in proportion to loans, on which commercial bankers insist. On the other hand, if the cash item is larger than 20 per cent of the total current debt, it might indicate ultra-conservatism and failure to put the funds to work for the profit of the enterprise. If correctly stated and free from incumbrances, this item should be accepted at its face value in determining its debt-paying power.

Accounts Receivable.—Next to cash, the accounts receivable item represents the most liquid asset. They are merely book accounts, or "open" accounts, with customers. This item should include all unpaid claims against solvent debtors arising from the sale of goods or services. Obviously, only those accounts should be covered by the item under consideration which can be reasonably relied upon for the payment of creditors' claims, as determined by past experience and from information on hand concerning the debtors.

This account should not include items reasonably known not to be collectible; advances to salesmen and other employees;

loans to officers; overdrafts of partners, which really partake of the nature of withdrawals from the capital investment; balances covering merchandise shipped on consignment; and loans to subsidiaries, which are not to be collected in the normal course of business activity but constitute a rather permanent investment.

In order to bolster up the accounts receivable item, makers of statements not infrequently include mere bookkeeping balances, which are not to be collected in the normal course of business activity and which cannot, therefore, be relied upon for the payment of debts. To provide for such contingencies, allowances should be made in arriving at the net worth of this item. In any event, a normal allowance must be made for bad debts, for even though only solvent debtors be included, it still remains uncertain whether all of them will be willing and able to meet their obligations at maturity. The percentage of such normal allowance or deduction varies with different houses and different lines of trade from less than one-half of 1 per cent to as high as 10 per cent. Should no distinction be made between the good and collectible accounts and those which are distinctly inferior, a much larger percentage will necessarily have to be written off.

The Assignment of Accounts Receivable.—Credit grantors are vitally interested in this point and a question to that effect is invariably included in the form of statement the maker is required to fill out. If this asset is in any way encumbered, its net worth, as well as the current ratio, are considerably affected.

The credit company to which accounts receivable are assigned usually advances approximately 77 per cent cash to the assignor. In addition to that, it sets aside a reserve from the accounts sufficient in size to cover its charges. The reserve ordinarily amounts to about 3 per cent, although it varies considerably with the degree of the collectibility of the accounts assigned. The remaining 20 per cent constitute a margin of protection against some of the accounts which cannot be collected. Credit companies generally require that the 80 per cent of the accounts receivable assigned as collateral for the loan have a first or second credit rating in Dun's or Bradstreet's. As to the marginal 20 per cent, no specific provisions are made as a rule.

Credit companies usually charge for their services one twenty-fifth of 1 per cent per day on the face amount of the accounts

assigned from date of assignment to date of payment to the credit company. In addition a flat charge, usually amounting to $5 per $1,000 on the first $100,000 of accounts purchased by the credit company from the assignor during any one year is made.

Book accounts may be assigned for several purposes. If the discount rate on purchases greatly exceeds the borrowing rate on accounts receivable, merchants may borrow money on the latter in order to take advantage of the cash discount offered. Whether or not money can be saved in this manner, and to what extent, are determined by taking into account the size of the purchase involved, the rate of discount offered for cash payment, and the rate at which money is borrowed on the pledged accounts.

Assuming that goods amounting to $10,000 gross have been purchased on "2/10, net 30" terms, and that the rate at which money is borrowed on open accounts is 15 per cent, the cash discount obtained would amount to $200, and the sum paid for the loan of $9,800 for 20 days, with which to discount the bill, would approximate $169.69. In order to secure $9,800 from a credit company, the borrower would have to pledge accounts having a face value of about $12,727. The charge at the rate of 15 per cent per annum for a period of 20 days on the face value of the accounts sold amounts to $106.06. To this must be added the flat charge of $5 per $1,000 of face value of the accounts assigned, or $63.63, making a total charge of $169.69. In this instance the assigning merchant would save approximately $30.31 ($200—$169.69). From this calculation it is apparent that where the purchase involved is small, terms of sale less lucrative, or the rate at which money is borrowed on pledged accounts higher than 15 per cent per annum, it would hardly pay to assign accounts receivable for the purpose of taking advantage of cash discounts, even though some gain is to be had, because of the time and trouble in negotiating such a loan.

More often, however, open accounts are assigned for the purpose of obtaining the necessary relief when the concern is temporarily embarrassed and no other palliative appears available. Occasionally, the method may be resorted to, in order to secure funds with which to take advantage of apparently profitable purchases or otherwise to expand the business profitably.

Methods of Assignment.—Essentially, there are two ways in which accounts may be assigned, depending upon whether or not arrangements are made for the notification of the debtor whose accounts are involved in the transaction. Assignments may consequently be made openly or secretly.

Notification Plan.—Under this arrangement accounts receivable are assigned by the merchant to the credit company and a notice of the assignment, together with a request to remit direct to the company specified therein, is sent to all debtors whose accounts have been assigned. All subsequent invoices assigned are also stamped with a similar notice.

Non-notification Plan.—Under this plan a merchant assigns his accounts to a credit company, commission house, or other intermediary, under the agreement that the debtors of the assigning merchant are not to be informed of the transaction involving claims held against them by the assignor. The merchant is required to act in the capacity of agent for the assignee. He is to collect the accounts in the usual manner, but must maintain the margin or ratio, between the total value of the accounts pledged and the sum of the loan negotiated, called for in the original agreement. To accomplish this end, the agreement may require the assignor to apply all receipts from the assigned accounts directly to the reduction of the loan. Another way is for the merchant to substitute other accounts of equal value in place of those collected. If the assignor fails thus to account for the collections, he may become criminally liable, provided it is done with intent to defraud the assignee.

Other Methods of Financing Accounts.—Open book accounts may be sold outright, in which instance the purchaser thereof acquires the same right of action against the debtor as the original creditor had. Accounts receivable may also be discounted and guaranteed by commission houses. Commission houses specializing in the financing of accounts are known as "*del credere*" houses or "factors." Many institutions of this type are found in the textile trade. Under this plan, the financing house will advance a substantial percentage of the net value of the invoices, and at the same time insure the borrower against losses on such invoices arising from bad debts. Since the net value of the invoices pledged may be reduced by reason of returned goods and allowances, a margin of safety to secure the assignee against such reduction is considered essen-

tial. Hence, the practice of advancing only approximately 75 to 80 per cent of the net value of invoices pledged. In view of this guarantee against bad debt losses, all orders must be first approved by the lender's credit department. The invoices are also rendered by the lender and made payable to and collected by him. In return for these services, charges in the form of a commission are made, in addition to the interest on the funds advanced. When the bills are finally collected, deductions are made to cover the sum advanced plus the commission and interest charges and the remainder returned to the assignor. If the amount collected proves inadequate, the assignor must make good the deficit, except where such insufficiency arises from bad debt losses.

Arguments for Assigning Accounts.—Many arguments are advanced by credit companies in justification of the practice of hypothecating accounts receivable. They compare this method with that of discounting trade acceptances and bills or notes receivable, which they claim are but open accounts closed. They, consequently, argue that if the practice of discounting trade acceptances and notes receivable is legitimate, they see no valid reason why the practice of "discounting" accounts receivable should not be equally legitimate. If it is overtrading to borrow by the latter method, then it is overtrading to borrow by the former means, for both are essentially in the same category.

Credit companies further claim that the funds secured through hypothecating accounts receivable have seldom been used to commit frauds against unsecured creditors, although it is admitted that these funds have often been used to the detriment of the credit companies themselves, inasmuch as sums thus secured are practically in all cases used to pay off debts to insistent unsecured creditors. The result is that, in case the receivables pledged do not provide sufficient security, the credit company is the ultimate loser in the transaction. It is unlikely, however, that the accounts pledged would shrink over 20 per cent within the short period of the financing transaction.

Again, credit companies claim that the sale of accounts receivable does not affect the liquidity of the assignor's assets, nor does it change its net worth. On the contrary, it greatly improves the showing made by its financial statement, inasmuch as it substitutes cash for about 77 to 80 per cent of the accounts

receivable, leaving the remaining 20 per cent to 23 per cent as they were, except for the prior claim of the credit company to which they are subject if the 80 per cent cannot be collected.

Following this line of reasoning, credit companies refute the statement made by opponents of the practice that it leads to overtrading and speculation. They argue that a concern cannot overtrade, by selling 80 per cent of the merchandise for cash, which credit companies enable it to do indirectly, for the only difference between selling on terms, say, of 80 per cent cash against shipping documents and that of receiving 80 per cent cash for its accounts receivable, with the balance as soon as collected, is the contingent liability incurred by the assignor on the hypothecated accounts, which amounts to a loss of approximately 1 per cent of sales, according to the experience of credit companies. Yet the former practice is considered legitimate, while the latter is found objectionable. This attitude, say credit companies, is unreasonable and unjustifiable, and is based primarily on prejudice against a new method of financing which deviates from the customs of the past.

With respect to charges, credit companies claim that they are no more excessive than the cash discounts found in practically every line of trade. Since the charges of credit companies seldom exceed the cash discounts offered, it is argued that it makes no difference to a concern whether its customers or the credit company discount their bills. In this connection it is to be noted, however, that when customers discount the bills, all risk of loss from bad debts is at once obviated, whereas the assignor is contingently liable to the credit company for any amount which is uncollected, in addition to paying the high charges.

Arguments against Assignment of Accounts.—The general feeling among merchants and, particularly, bank creditors is against selling accounts receivable. It is unfair, they claim, to expect credit accommodations on single-name paper or merchandise on a mere verbal promise to pay at the same time that the credit company is secured by the borrower's accounts receivable, one of the most liquid assets. As a result of such security, the credit company is a preferred creditor in case of bankruptcy, while the others are simply general creditors.

Another reason why the practice of hypothecating accounts receivable is generally condemned by bankers and merchandise

creditors is that there is the feeling that strong concerns do not have to resort to this method of financing, while weak companies cannot afford it. It is argued that if a concern can present a good statement to a bank, there is no reason for selling its accounts receivable to a credit company, when reasonable sums can be borrowed from its bank at a much lower rate. On the other hand, if the company is weak, it is frequently advisable to confess the condition of affairs to its creditors and be nursed along by them rather than entrust the business to the care of the officials of a credit company, who charge large fees for their services and whose advice is probably seldom as competent as that of local bankers and merchandise creditors who better understand its financial condition.

A third objection to the practice of borrowing against receivables is the ease with which additional funds can be procured in this manner. As a result, the small and unsophisticated merchant is constantly tempted to overtrade and expand his business on an unsound basis. It is generally thought that a business should be able to finance its merchandise requirements without outside aid, but that it is entitled to accommodations to help carry its receivables. Consequently, when accommodations are sought on the basis of pledging accounts receivable, there is something wrong in the concern's financial structure, and this practice frequently serves as an indication of overtrading and speculation which is a very dangerous practice.

Probably one of the principal objections against borrowing funds on the assignment of open book accounts is the opportunity it affords unscrupulous and dishonest merchants to mislead their creditors as to the real status of their financial responsibility until it is too late for the general creditors to take protective measures. If such transfers or assignments were required by law to be recorded, creditors would be protected. As it is, too often the first notice which creditors receive concerning an assignment comes when failure is precipitated and the discovery is made that the debtor's accounts cannot be relied upon.

In the fifth place, raising capital by assigning accounts under the notification plan is unfavorable to the assignor, inasmuch as his business reputation is apt to suffer considerably when his customers learn of the assignment, which usually reflects financial weakness. In event the non-notification plan is used,

the creditors of the assignor are naturally dissatisfied and resentful when the discovery is made that the accounts of the debtor have been secretly assigned.

Sixth, the cost of borrowing funds in this manner has its objectionable features. Such accounts not being considered a high-class collateral, the rate of interest charged on these loans is generally much higher than the current rate on other kinds of loans. In addition, a bonus or commission is generally charged for negotiating the loan, making an average of approximately 15 per cent, the rates on individual assignments varying with the nature and character of accounts and ranging to more than 30 per cent.

Obviously, the average merchant cannot afford to pay exorbitant rates of interest without feeling its bad effects, unless resorted to at rare intervals for the purpose of taking advantage of unusually profitable transactions. As a matter of fact, a debtor resorts to this plan of financing only when hard pressed for ready funds with which to meet obligations to insistent creditors. This practice, therefore, reflects a weakened condition of the debtor, which may be accentuated by the excessive fees paid for the money thus borrowed and may thereby hasten a precipitation of failure.

Seventh, credit companies to the contrary notwithstanding, it is believed that although the sale of accounts receivable immediately places the assignor in a stronger financial position on account of substituting cash for open book accounts, ultimately he is worse off. Any increase in cash, as a rule, proportionally increases the owner's immediate ability to meet his obligations. But, in order thus to secure $9,800 in cash temporarily, as shown in the example cited, the assignor must definitely pledge $12,727 of his accounts receivable. In this manner, the credit company secures a preference against the amount, thereby appropriating a portion of the subject's most liquid asset as security for its loan, whereas other creditors are expected to extend accommodations on an unsecured basis. Furthermore, the company's current assets have been reduced from $12,727 in accounts receivable to $9,800 in cash. In addition, the assignor is contingently liable for the $9,800 which must be paid in case the accounts prove uncollectible. Besides, it is not likely that the cash will remain long in the hands of the borrower, and if used to speculate in merchandise or for

investment in fixed assets, which may be an unwarranted assumption, although not in its entirety, the borrowing concern is placed in a position of having as a result a smaller portion of a slower asset in place of accounts receivable. Such a situation is less likely to obtain when banking and merchandise creditors are the only ones who, through their cooperation, regulate and control a debtor's ability to overtrade.

As a final argument against the practice, "regular" creditors point to the large percentage of concerns who abandon the credit companies and turn to the usual institutions for financing as soon as they are extricated from their financial difficulties.

Notes and Bills Receivable.—This item should include only negotiable promissory notes received from solvent purchasers in temporary settlement for goods sold and delivered. If trade acceptances are customarily taken by the firm in payment for goods sold, as in the raw silk trade, they should be listed separately to facilitate distinction between the two items for purposes of analysis. The notes receivable account should not include notes given in settlement of loans to individuals, nor should it contain notes covering overdrafts and similar obligations of partners, officers, directors, employees, subsidiary companies, or any other similar obligations. From this account should also be excluded all notes which have been discounted, assigned, or transferred. In a word, only those notes should be listed under this heading which are the outgrowth of commercial transactions, incident to the normal course of business activities.

To determine the approximate value of notes receivable, the analyst should know the kind of business and terms of sale granted by the firm under consideration. In most lines of trade, debts for goods sold are usually evidenced by open book accounts. Under these conditions, notes are not taken in the regular course of business. Where this system prevails, notes receivable may represent extensions on accounts already past due, put into note settlements. Hence, a substantial amount of notes receivable, unless it is customary in the trade to operate on that basis, frequently indicates a large past-due indebtedness and reflects laxity in the performance of the credit granting and collection functions. Irrespective of the terms of sale, a certain percentage should be deducted in estimating the value of notes receivable, to provide for bad debts. This percentage is to

be based on the average percentage of losses in the given trade and upon the debtor's credit policy and methods.

Merchandise Inventories.—Merchandise constitutes one of the most important parts of the current assets, but is appraised with difficulty. This item covers all sorts of goods which are to be sold in the normal course of business. It includes raw materials, goods in process, and finished products to which ownership is claimed by the firm submitting the statement. All merchandise stocks which have been pledged as security or which are subject to liens as well as supplies must necessarily be omitted.

Another item which calls for some consideration in this connection is that of merchandise consigned for sale. This should be excluded from the merchandise item of the consignee but included instead in the inventory of the consignor. Such merchandise constitutes the property of the one who has consigned it and does not, therefore, belong to the consignee. The latter merely acts in the capacity of agent charged with the duties specified in the contract governing the relationship between the two parties. He has no direct financial liability to the consignor, for he is only required to exercise "ordinary care and diligence" in seeing that the merchandise is disposed of in accordance with the provisions of the contract.

In connection with an appraisal of the value of merchandise inventories, several important questions arise, relating to the kind and condition of the stock of goods, mode of ascertaining the quantitative measure of the merchandise on hand, and method employed in pricing the inventory in order to secure a money measure of the merchandise in stock.

If the statement is submitted by a manufacturing concern, it is essential to know the proportion of the stock of goods that is in the state of raw materials, goods in process, or finished goods, for merchandise in the shape of raw materials is of much greater value proportionally in case of a forced sale than are goods in process. Raw materials are not subject to radical style changes and are, therefore, more marketable, *i.e.*, readily convertible into cash, while goods in process require much additional material, labor, and time before rendered salable. For the same reason, finished goods can be more readily disposed of than merchandise in process.

In all cases, adequate allowance must be made for old stock

and depreciation. Although merchandise is normally sold at a profit, nevertheless circumstances may arise which greatly diminish its value, since all goods are subject, in varying degrees, to changes in style, declines in value which accompany the downward movement of the business cycle, errors in demand anticipation, and physical deterioration. Obviously, no uniform basis or scale for writing off the merchandise account, which would apply to all lines of trade, can be profitably established. Whereas a 10 per cent deduction from the merchandise item may suffice for the grocery trade, 20 to 25 per cent will probably be required in the dry goods line, 25 to 30 per cent for clothing, and as high an allowance as 35 to 50 per cent for the millinery business. The percentage thus varies in the proportion to which the goods under consideration are subject to the changes hereinbefore enumerated.

A consideration of somewhat less importance is the method employed in arriving at a quantitative measure of the stock of merchandise on hand. It is of some importance to know, in order to gage the accuracy of the figure, whether the item represents an actual or physical inventory or is arrived at by means of a perpetual inventory system. In some instances, it may represent simply a guess. It should be borne in mind that, as a rule, when the figures given in the statement are in round numbers, omitting cents and the last digit in the dollars column, the conclusion may reasonably be drawn that the inventory has in all probability been a mere guess and represents no actual values. In this connection, it is also well to note the date of the inventory. If taken at the close of the season, the quantity of goods should be at the low-water mark, and *vice versa*.

With the adoption of different practices in regard to pricing inventories, it is essential to know what method has been employed. Some houses inventory their merchandise at cost; others at selling price; whereas a third group value their merchandise stocks at cost or prevailing market prices, whichever is the lower. Conservative practice requires that the last of the three methods be employed on the assumption that the debt-paying power of a commodity is determined not so much by its cost as by the amount at which it can sell, which is, in turn, reflected in the prevailing market price at which it could be purchased for resale. When inventories are valued at selling price, appropriations are made of anticipated profits the realization of which

is highly problematical. Even though profits are made as a result of a sale, they properly belong to the subsequent accounting period. Moreover, in following this practice, it is easy to overlook the expenses chargeable against a sale of the goods under consideration.

Investments.—This includes short-term notes, stocks, bonds, and other securities of subsidiaries or other companies, held by the maker of the statement. These securities may be readily marketable and invested in only temporarily, or may be held for relatively long periods for purposes of control. The value of securities of the first type only should be included among the current assets. Their value for debt-paying purposes is readily ascertainable, if listed on an important stock exchange. Otherwise, they are greatly discounted or entirely disregarded by the credit grantor.

Deferred Assets.—In this group are included all charges paid in advance and which are properly applicable to a subsequent period, such as unexpired insurance premiums, taxes, and interest. Having no direct debt-paying power, the significance of these items lies in that they reflect the system of accounting which is employed by the maker of the statement, which is no unimportant criterion of management ability.

Plant, Machinery, and Tools.—These constitute an important part of the fixed assets and, not unlike the other items of the same class, are not to be sold in the normal course of business activity. They, therefore, do not contribute directly to the ability of the owner to meet obligations currently maturing. Nevertheless, they add to the stability of the business and in event of a forced liquidation the proceeds from their sale will be applied in payment of creditors' claims, according to priority. To be sure, under such circumstances, the sum realized would probably amount to a small percentage of the listed or book value. However, these as well as some of the other fixed assets, are extremely important in analyzing financial statements, as their ratios to other items disclose methods and policies employed the effect of which is either to increase or diminish the firm's earning capacity and credit responsibility.

In estimating the worth of these properties, an adequate allowance must be made to cover depreciation in value due to wear and tear and obsolescence, if they are listed at cost and no sufficient reserve has been provided.

Most forms of financial statements provide a space for the listing of real estate. The maker is required to list each parcel separately at cost price. By comparing these figures with the assessed valuation, some check is afforded against any overstatement of assets. Such comparison, assuming correct cost price to have been given, also affords an opportunity to study fluctuations in real estate values, in the neighborhood in which the debtor is located.

Furniture and Fixtures.—Adequate allowance should be made for depreciation, and since the worth of this item in case of a forced sale is considerably less, a substantial percentage is sometimes written off by credit grantors. In this connection it should be ascertained, if possible, whether the size of the investment in this item is consistent with the requirements of the business.

Intangible Assets.—In this group are included good will, trade-marks, patents, copyrights, certain contracts, franchises, and other assets of like nature. Most of these are practically disregarded by credit managers in analyzing financial statements, for, it is argued, they can only be realized on when the business is sold and only when they yield satisfactory returns. Although they are not available for debt-paying purposes, if representing real value they should always be included among the fixed assets, inasmuch as intangibles may sometimes constitute the chief and most valuable asset of a concern, as in the case of the patents of the United Shoe Machinery Company.

CONTENTS AND VALUATION OF LIABILITIES

Accounts Payable.—This item should represent the total sum owing to creditors on open account, and it is advisable, from the standpoint of creditors, to have it segregated into amounts not due and amounts past due. The amount owing for merchandise, if listed as a separate item, should be excluded from accounts payable. The reason for showing the amount owing for merchandise separately is because it prevents understatements, for this figure is readily verified. Such requirement acts as a deterrent from falsification and aids in detecting tendencies to overstocking, which usually precedes bankruptcy. This item should normally be small, for open accounts must be settled promptly in order to take advantage of cash discounts.

Notes Payable.—Under this heading three divisions are to be found:

1. Notes payable to banks, which represents money borrowed by discounting debtor's own notes. If the amount is large, it may represent loans obtained for the purpose of discounting bills of purchase. Good banking accommodations, as represented by this item, are, as a rule, a semblance of strength.

2. Notes payable to merchandise creditors for goods purchased. If the amount is large, it generally represents trade acceptances given and outstanding. Should this be the case, a correspondingly low figure should appear opposite the "owing for merchandise" item. Again, if notes are not regularly employed in the trade in settlement for purchases, these notes probably represent settlements of past-due purchase accounts and are drawing interest, which ordinarily indicates that the debtor's credit is strained.

3. Notes payable to others include notes given when obligations are incurred from sources other than those mentioned, such as officers, directors, relatives, and friends. Their presence in large amounts calls for care and caution on the part of the credit manager, because these means of securing the necessary funds are resorted to when all banking credit has probably been exhausted. Moreover, in case of insolvency, it is natural for the debtor to protect his friends and relatives to the detriment of his other creditors.

Deferred Liabilities.—These represent accounts of rent, taxes, wages, and similar items accrued during the period covered by the statement but not payable until the subsequent accounting period. In determining the total of liabilities currently payable, this item is practically always added by conservative credit managers.

Mortgages.—Liabilities secured in this form may have been assumed as part payment for the property during the acquisition of title or may have been executed at a later date. Ordinary mortgages represent indebtedness secured by a pledge of real estate, whereas chattel mortgages represent indebtedness secured by personal and other movable property, such as a stock of goods, automobiles, refrigerator boxes, cash registers, and the like. In determining the residual value of the various assets, a knowledge of these encumbrances is absolutely indispensable.

Bonds.—In the event of forced liquidation, bondholders' claims, unless the bonds are secured by specific property, take precedence to those of bank and merchandise creditors. Hence, if the bonded indebtedness is large, little or nothing may be expected by others than bondholders upon involuntary dissolution. This is a consideration requiring particular attention when bank or merchandise creditors are contemplating throwing the debtor into bankruptcy.

Contingent Liabilities.—These liabilities are potential and do not become real until and unless certain contingencies occur. Because they do not constitute real liabilities for the present, they are not chargeable, and should not be included among the regular liabilities. Their existence should be disclosed in supplementary remarks, however.

Contingent liabilities arise through the following transactions:

1. When the debtor guarantees payment of another's account. In case of default on the part of the person whose account is guaranteed the guarantor becomes liable for the sum involved. Thus, his liability is contingent upon the default of the real debtor to pay his obligations. The liability as guarantor also arises out of agreements, leases, and the like.

2. When a merchant indorses his notes receivable or trade acceptances for the purpose of discounting them at the bank. Should the maker or drawer refuse payment when the notes are presented for payment at maturity, the indorser becomes directly liable to the bank.

3. By indorsing a note for the accommodation or benefit of another. The evils of this practice have already been discussed in an earlier part of the book and will, therefore, be omitted at this point.

4. When commitments for future delivery of merchandise purchases are made. In this case the buyer becomes contingently liable.

Capital represents the net worth or book value of a business operated as a single proprietorship or a partnership.

Capital Stock.—If it has a par value, capital stock is stated at that figure at all times. If it possesses no par value, the amount of this item should represent the sum actually received from the sale of the security. Only that stock which is actually issued and outstanding should thus appear in the balance sheet.

Surplus is the difference between the net worth of the business

and the par value of the capital stock issued and outstanding. It is the excess of book or economic values over the amount which the liabilities and par value of the capital stock issued and outstanding represent. A surplus may arise through the following types of transactions:

1. Payments made directly by stockholders, forming the so-called "paid-in" surplus.
2. Capital stock premiums and purchase by the company of its own securities below par.
3. Stock assessments and conversion payments.
4. Stock donations and gifts and contributions from outsiders.
5. Sale of capital assets for an amount in excess of their book value.
6. Reappraising and writing up the book value of certain assets.
7. Normal accumulations of profits as determined by the profit and loss account balances.[1]

Under normal conditions only the earned surplus, or that arising from the normal accumulations of profits resulting from the ordinary operations of the business, is available for the payment of dividends. The surplus item, if any, plus the capital stock constitutes the owners' equity in the enterprise. If a deficit is incurred, to determine the owners' equity, it should be deducted from capital stock instead of placing it on the assets side of the balance sheet, as is sometimes done.

A reasonably substantial surplus is usually looked upon with favor, for it indicates a safe equity. When compared over a period of years, earned surpluses will indicate whether the business is fundamentally sound and is operated on a paying basis, or whether it is retrograding or standing still. However, when the earned surplus becomes so large as to be entirely out of proportion to the capital invested, there is danger of the business being suddenly handicapped by the payment of large dividends out of working capital. It is, therefore, advisable, from the standpoint of credit policy, to capitalize the surplus as soon as it becomes so large as to be out of proportion to the amount of capital invested, except where no par-value stock

[1] Beckman, T. N., "Sources and Treatment of Surplus," *The Journal of Accountancy*, May, 1923.

is issued and carried on the books at no definitely permanent figure.

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Brewster, S. F.: "Legal Aspects of Credit," chap. 11.
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CHAPTER XV

FINANCIAL STATEMENT ANALYSIS

Unless properly interpreted and skilfully analyzed, financial statements are of little significance as a basis for credit extensions. Credit managers should, therefore, thoroughly understand the theory underlying statement analysis and possess the training and experience requisite to its effective application.

Procedure.—The first consideration is whether or not the statement is audited and by whom. By having the records and statements audited by a responsible firm of chartered or certified public accountants, creditors can feel more sure that the figures presented are accurate and reflect the true condition of affairs. An audited report is of little significance unless a certificate by the accountants responsible for the audit is appended, because audits vary in their scope and for that reason certifications vary. Hence, it is essential that a creditor read the certificate carefully so as to ascertain the character of the audit and the conditions underlying it. Although accountants find it necessary to conform to the wishes of their clients, nevertheless no responsible firm will deviate from sound and well-recognized accounting principles in behalf of unscrupulous clients. Consequently, only high-grade and reliable firms whose opinions are impartial should be employed, if the confidence of creditors is to be gained as a result of an audit.

Scientific statement analysis requires that the data submitted be next carefully scrutinized in order to arrive at a conservative valuation of the various items covered. Some assets will have to be eliminated entirely, as worthless; others will be "shaded" or written off a certain percentage as dictated by sound judgment and past experience. The contents of both assets and liabilities will be tested and verified in accordance with the requirements set forth in the preceding chapter.

Following their verification and "shading," the various items comprised in the statement should, for the sake of convenience, be reclassified on a "comparison of statements" form, for the

data submitted differ widely in arrangement unless presented on a blank furnished by the recipient. The final step consists in the determination of the debtor's true financial responsibility and business capacity as ascertained through the existing relationships between the different assets, liabilities, and residual equities.

The Ratio Theory.—The inadequacy of a mere comparison of amounts frequently leads the analyst astray. A comparison of bulk fails to stress sufficiently the quality and relationship of assets and equities and, consequently, leaves much to be desired in scientific statement analysis. For these reasons, attempts have been made within recent years to develop and establish a set of proportions or ratios to serve as a guide in a systematic and orderly procedure in analytical statement studies. Probably the most active among students of the subject under consideration is Alexander Wall, Secretary of the Robert Morris Associates, who has devoted considerable of his time to formulating a system of internal and type analysis. The more important ratios from the standpoint of the credit grantor are as follows:

1. Current Ratio
2. Ratio of Net Worth to Fixed Assets
3. Ratio of Sales to Receivables
4. Ratio of Sales to Merchandise
5. Ratio of Net Worth to Debt
6. Ratio of Sales to Fixed Assets
7. Ratio of Sales to Net Worth
8. Ratio of Insurance to Merchandise.

As indicated, these ratios comprise as related variables the current assets, current liabilities, Merchandise, Receivables, Fixed Assets, Net Worth, Total Indebtedness, and Net Sales. These elements are thus combined into eight relationships so as to produce a similar number of ratios of varying degrees of importance, the probable order of which is disclosed in the above arrangement. Other ratios in which a credit grantor displays keen interest are:

The Operating Ratio.
Ratio of Earnings to Investment.

Obviously, a study of ratios necessitates the adoption of some sort of a barometer by means of which the various proportions derived may be measured in order to determine their exact

value. Accordingly, attempts have been made to evolve a normal set of ratios representing averages derived from an examination of a large number of statements. A better method by far is that of determining, through an analysis of a large number of statements, the "common" ratios, or those which are characteristic of most of the concerns represented in the study. Once such a normal is established, it can be used as a yardstick which, when properly applied, will indicate the percentage any given ratio should show to approach a normal condition. All of the ratios have been so arranged that an increase in percentage of any individual ratio reflects improvement, and a decrease denotes retrogression.

Examples of some of the analytical studies already made are presented in the accompanying table, in which several type ratios are shown for a number of companies in ten different lines of trade. The first nine are based on figures collected during 1919, while the ratios in the rubber industry are based upon the figures of ten of the largest companies producing over 60 per cent of the estimated production in the United States covering the year 1922.

In the application of a barometric plan of statement analysis, it is to be noted that at least three factors should be taken into consideration. These are: line of trade, location of the business represented by the statement under analysis, and the date the statement was drawn up. The assets of different lines of trade vary considerably in their stability. The greater the style element involved in the merchandise handled, the less certain and stable is the value of the inventory, and *vice versa*. Whereas high ratios would be required for women's ready-to-wear establishments, much lower ones will prove adequate for grocers dealing in staple goods. Hence, it is essential to recognize the differences between lines of trade and establish a set of normal ratios for each type of business.

Similarly, concerns in the same line of trade will produce different normals in different sections of the country. Obviously, different parts of the country are affected unequally by the condition of prosperity, transportation, labor, and other economic factors of like nature. For these reasons, it is advisable to establish normal ratios not only on a national scale but on a sectional basis as well.

Lastly, the time of the year in which the statement is made

CREDIT BAROMETRICS*

Types of business	Wholesale dry goods	Wholesale hardware	Wholesale grocers	Drugs	Tanners	Farm implements	Lumber	Packers	Boots and shoes	Rubber and rubber goods†
Number of companies studied	83	99	205	21	28	20	54	19	66	10
Ratios, per cent:										
Current ratio	2.23	2.84	2.38	2.69	2.47	3.56	2.59	2.35	2.25	3.22
Net worth to fixed assets	3.57	3.94	3.40	1.42	2.83	1.91	1.82	1.84	2.59	1.10
Sales to receivables	4.62	5.43	7.88	8.48	5.93	3.30	4.45	10.27	5.03	4.90
Sales to merchandise	3.91	3.28	5.64	3.49	2.94	2.09	3.67	8.30	3.62	3.44
Net worth to debt‡	6.36	4.30	5.91	2.13	5.09	3.84	3.25	8.06	6.52	1.66
Sales to fixed assets										1.30
Sales to net worth	2.72	2.28	3.99	1.37	2.16	1.03	1.47	4.83	2.79	1.18
Receivables to merchandise	8.46	6.03	7.16	4.12	4.96	6.35	8.24	8.07	7.20	7.03

* Adapted from a "Study of Credit Barometrics," by Alexander Wall, Federal Reserve *Bulletin*, Mar., 1919, p. 243. The last two figures are omitted here and the order in which the ratios were presented has been changed so as to comply with the author's idea of their relative importance.

† Adapted and calculated from figures presented in "The Rubber Industry Since 1916," *The Credit Monthly*, Dec., 1923, pp. 10–11.

‡ In all but the last line of trade, Worth to Debt is given instead of Debt to Worth. Although the latter is much to be preferred, because it falls in line with the general scheme of considering every increase in the ratio an improvement, and *vice versa*, nevertheless the other figures had to be substituted, they being the only ones available in the study referred to.

will make a substantial difference in its proportional relationships. Because of seasonal variations in the demand, the stock of goods may be abnormally large during certain parts of the year and exceedingly low during others. A comparison of statements taken at either of these dates with the normal established will, therefore, prove misleading, unless such differentiation is recognized by the analyst and allowance for deviations made correspondingly.

Current Ratio.—This ratio is derived by dividing the current assets by the current liabilities. It indicates the margin between the amount currently due and that currently owing. Notwithstanding sporadic opinions to the contrary, common practice has proved that it is possible to develop certain more or less fixed ratios which are helpful in measuring the financial responsibility of a credit risk. The first step towards the development of a study in proportions has been the adoption of a 2-to-1 ratio of current assets to current liabilities, which means that, in order to establish a favorable credit proportion, the statement must show two dollars of current assets for every dollar of current liabilities. This 2-to-1 rule is based on the theory, or rather knowledge acquired through experience, that a shrinkage might easily occur in assets but seldom in liabilities. Some accounts receivable may become slow and bad, and merchandise go out of style, become antiquated, or otherwise unsalable, whereas the indebtedness is rarely subject to shrinkage. Hence the necessity of a margin. The 2-to-1 or 200 per cent ratio allows a 100 per cent margin of safety, which is generally acknowledged as ample and has thus been accepted as a standard ratio after considerable experimentation.

In the days immediately following the adoption of the 2-to-1 ratio it was the policy of many banking institutions, it is said, to refuse credit to a merchant who could not produce such a proportion between current assets and current liabilities. In present-day practice, however, the rule is seldom strictly adhered to, probably because of the recognition of differences in types of business, location, date of issue of the statement, and other similar factors the effect of which is to vary somewhat the proportions involved. Whereas some lines of trade require a 2-to-1 ratio, others may necessitate a proportion of as high as 10 to 1, and still others will prove satisfactory risks even though their ratio is only 1 to 1. To extend credit accommodations

to a merchant whose current liabilities exceed the current assets, representing a "floating debt," is equivalent to purchasing a lawsuit, since there is no likelihood that the current obligations will be met at maturity.

Working Capital in Relation to Credit Limits.—"Working Capital" of a business is represented by the excess of current assets over current obligations. It is the fund upon which reliance for payment of bills at maturity is placed by credit grantors. This sum thus measures in a sense the credit capacity of the business or the power to discharge obligations promptly.

Having ascertained the amount of working capital available in the business, the credit grantor is thereupon confronted with the question of determining the amount of credit which may safely be extended. It is to be noted in this connection that it is doubtful whether any limit on a customer's account can be established definitely which will be anything but an approximate and perhaps arbitrary amount. Theoretically, however, a calculation is possible, which, though arbitrary, is nevertheless essential. It is needless to say that the result may be adjusted up or down the scale in accordance with individual circumstances. Furthermore, the credit limit never attains such rigidity as not to permit of changes warranted by additional knowledge gained from time to time.

In brief, the method of procedure in determining the credit limit is somewhat as follows: The working capital of the merchant under consideration is multiplied by the known or estimated annual stock turnovers; the result is divided by the number of principal sources from which purchases are made. In this manner the annual purchases which the concern is entitled to make on time from any one source is roughly determined. This result is finally divided by the annual rate of stock turnover to ascertain the amount of credit to which the concern is entitled from a single source of supply at a given time. To illustrate, let us assume that a concern has a working capital of $20,000; that the stock turns approximately five times a year; and that it is reasonable to assume that the major portion of its goods is purchased from 25 sources, or that the goods of one supplier constitute approximately one-twenty-fifth of the entire stock of merchandise. The annual purchases of the concern would be $100,000 ($20,000 × 5); its annual purchases from one source would be

$4,000 ($100,000 ÷ 25); and its credit limit at any given time from one source of supply, $800 ($4,000 ÷ 5).

Need for Other Ratios.—The adoption of the Current ratio theory is in itself merely a quantitative affair, measuring current assets in bulk against quick liabilities in their entirety. While this is of great importance, it is nevertheless quite as important, or possibly of greater significance, that a qualitative analysis of the current assets be made to ascertain their character and liquidity, for a smaller current ratio may be more than offset by fresh and rapidly collectible accounts and by merchandise which is readily disposed of. Again, too much stress on the current ratio leads inevitably to "window dressing," for several methods may be employed by prospective borrowers whereby the ratio could be improved temporarily. One of them, for instance, is to sell merchandise or other property to interested parties, retire part of the debt with the proceeds, and, after they have thus served the purpose of improving the current ratio, repurchase the assets. For these reasons, other ratios have been developed which qualify and add to the value of the current ratio as a measure of credit capacity.

Net Worth to Fixed Assets.—This ratio is derived by dividing the net worth by the total fixed or non-current assets. It indicates the percentage of net worth or owners' equity, tied up in plant, machinery, equipment, and other fixed properties. The margin over and above 100 per cent indicates the proportion of the net worth provided for working capital.

Unless permanent working capital has been provided through the issue of bonds or short-time notes, it is essential that owner-controlled funds be secured for the purpose. Good business judgment argues against relying upon merchandise or bank creditors to supply funds needed for that part of the working capital which is permanently required in the business.

If an increase in net worth is accompanied by a decrease in the ratio of Net Worth to Fixed Assets, the inference that may reasonably be drawn is that the owners have expanded the plant more rapidly than warranted by the normal growth of the business. Such a development, where liquid assets are converted into fixed assets, is likely to occur in a period of rising prices, when optimism prevails and the hope of future large profits stimulates expansion to a point of embarrassment. A declining ratio under such circumstances should be a danger signal to

creditors, calling for extreme precautions in their dealings with the subject thus affected.

Sales to Receivables.—This ratio is found by dividing the total net sales for the year by the total of accounts and notes or bills receivable. It indicates the proportion of the annual sales which are carried on the books as receivables, and denotes the economy and efficiency observed in handling capital tied up in receivables. The older an account becomes, the heavier the carrying expenses are, the greater the possibility of losses from bad debts, and the poorer the return on the investment.

A high ratio of Sales to Receivables, within certain limits, more than offsets the disadvantage from a current ratio somewhat below the normal. On the other hand, a low character of collectivity and stale receivables, as reflected by a low ratio of Sales to Receivables, necessitates a much higher Current ratio than would have been otherwise required, in order to secure a wider margin of safety against shrinkage caused by bad debts.

To determine the normal ratio of Sales to Receivables, a knowledge of the concern's terms of sale is essential. To illustrate, let us assume that the sales for the year amounted to $2,222,063, and that the receivables were $206,896. By dividing the sales by the receivables we obtain a figure showing the number of times these receivables are turned over during the year, which is 10.74 in this case (2,222,063 ÷ 206,896). To determine the number of days of sales carried on the books, divide 10.74 into 365, the days of the year, the result being approximately 34 (365 ÷ 10.74). If the firm sells on 30-day terms, the ratio approaches a normal condition. As a matter of fact, under ordinary circumstances, a comfortable condition of affairs is indicated as long as no more than 25 per cent of the previous month's receivables are outstanding at the end of the current month. Thus, 35 to 40 days' receivables outstanding on a statement of a concern selling on 30-day terms would undoubtedly make a favorable showing.

To measure the liquidity of the receivables over a period of time, it is, of course, necessary to make a study of comparative statements. Should such successive statements disclose an increase in the bulk of the receivables, there is no cause for anxiety, provided the sales have also increased either in the same proportion or at a greater rate of speed, which fact will be shown by a constant or declining ratio, respectively. If, however, an

increasing volume of sales is accompanied by a decreasing ratio between sales and receivables, it may be presumed that the liquidity of the receivables is diminishing and that a greater proportion of past-due accounts is carried on the books.

It is conceivable that, by adopting too strict a credit policy, this ratio may be raised considerably. But since this is done at the expense of sales volume, it is seldom, if ever, justifiable, hence the statement that the higher the ratio, *within certain bounds,* the greater the liquidity of the receivables, and consequently, the credit capacity of the risk.

Sales to Merchandise.—To secure this ratio, divide the net sales by the total merchandise inventory. It shows the number of times a merchant is able to convert his stock of goods into cash or receivables. Thus, if the merchandise on hand amounts to $15,000, and the sales for the year are $60,000, the approximate number of times a merchant is turning his stock is determined by dividing the inventory into the annual sales, which in this instance is four times (60,000 ÷ 15,000). Although this is the method commonly employed by credit managers in ascertaining the approximate rate of stock turnover, it is nevertheless inaccurate and not in keeping with sound practice, because sales under such circumstances are figured at selling price, which necessarily includes gross profits, whereas the inventory is usually priced at cost, or at cost or market whichever is lower.

Much confusion is current everywhere in the methods of determining stock turnover. The true turnover can be found only (1) by dividing total sales by the average selling value of the merchandise on hand, or (2) by dividing the approximate cost of all goods sold by the cost of the average stock kept on hand. Should the inventory not represent the average stock of goods on hand, that fact should be taken into consideration. In order to indicate clearly the two respective correct methods of determining stock turnover, two illustrations are submitted. It is assumed that the merchant under consideration has realized a gross profit of 30 per cent.

1. Sales Price Basis

$$\frac{\text{Total sales at selling price (\$60,000)}}{\text{Inventory at sales price (\$21,428.40)}} = \text{Turnover (2.8 times).}$$

2. Cost Basis

$$\frac{\text{Total sales at cost (\$42,000)}}{\text{Inventory priced at cost (\$15,000)}} = \text{Turnover (2.8 times).}$$

Another common method of determining the stock turnover on a cost basis is to take the merchandise inventory on hand at the beginning of the fiscal period and add to it the purchases during the year, or the cost of manufactured goods in the case of a manufacturing concern. From this total deduct the merchandise on hand at the end of the year. The resulting figure is the amount of merchandise at cost price that has been sold during the year, which, when divided by the average inventory at cost, gives the stock turnover for the year. For example:

Merchandise on hand at beginning of year	$14,500
Purchases during year	43,000
Total	$57,500
Less merchandise on hand at end of year	15,500
Cost of goods sold during year	$42,000

Stock turnover: $42,000 ÷ 15,000 =2 .8 times.

Knowing either from normals established in the trade or from experience what the rate of turnover should be, it is not difficult for the credit analyst to discover the degree of business ability possessed by the risk and the freshness and salability of the stock of merchandise. Rapid stock turns indicate good management, fresh stock, and liquid assets. A slow turnover, on the other hand, reflects possible overvaluation of inventory, too large an investment in merchandise, careless buying, and possibly dead and unmovable stocks.

Worth to Debt.—To find this ratio, divide the net worth by the total debt to outsiders, both current and funded. The net worth constitutes the owners' equity in the business enterprise, consisting in the case of a corporation of the difference between the sum of all assets and the liabilities. In partnerships and single proprietorships it is designated as capital and proprietorship, respectively. This ratio indicates the proportional relationship which exists between money or goods secured on credit from outsiders and the sum invested by the owners of the business.

As the proportion between funds invested by the owners increases over sums borrowed, the concern becomes less dependent upon the decisions and good will of its creditors for working capital. Another way of putting it is the higher the ratio, the less extended becomes the reliance of creditors upon intangible factors involving character and moral risk. On the other hand,

an abnormally low ratio of Worth to Debt calls for considerable care and investigation on the part of the conservative credit grantor. Because of the effective significance of a proper balance between creditors' claims and owners' equities, a low ratio should cause the management immediately to revamp its affairs so as to enable it to maintain the integrity of its credit standing.

In case a considerable portion of the debt is funded, it is recommended that a Net Worth to Current Debt ratio be established in order to determine whether or not this ratio is sufficiently high, for, as the proportion of funded debt increases, the necessity for current obligations should be reduced correspondingly.

Sales to Fixed Assets.—This ratio is secured by dividing the net sales by the total fixed assets and serves to indicate the dollars of sales for every dollar invested in plant, machinery, equipment, and other non-current assets.

When a large ratio of Sales to Fixed Assets is shown, it means that the degree of plant utilization is relatively low, which amounts to the same thing as saying that the concern is too large for the volume of business transacted. It is to be noted that the amount invested in fixed assets varies considerably with different types of business. Wholesale grocers, for example, show sales of anywhere from $8 to $14 to every dollar of fixed assets, whereas steel companies, where the investment in plant and equipment is exceedingly heavy, may show a ratio of less than 1 to 1. Hence the necessity for a normal for every line of trade.

This ratio can be used to advantage in conjunction with that of Worth to Fixed Assets. If both of these ratios are below normal or falling, a condition obtains where plant is enlarging proportionally at a greater rate than worth, and where sales are not keeping pace with the increase in size, which is indicative of a dangerous and pernicious policy of overexpansion. When such a situation is discovered, it behooves both the credit grantor and the credit risk to revamp conditions whereby the plant is either decreased gradually or else production and selling efficiency enhanced so as economically to justify the size of the enterprise.

Sales to Net Worth.—To produce this ratio, divide the net sales by the net worth. By this means the dollars of sales for every dollar of owners' equity is determined.

The theory underlying the development of this ratio is based on the assumption that there is an optimum point in the activity of invested capital. Assuming a given margin of profit, the greater the volume of sales, the greater the profits on fixed capital and net worth. Hence, a rising ratio indicates greater activity of the funds invested, and, consequently, larger earnings. If such ratio be too high, however, it may reveal a condition where the concern is overextending its operations and transacting too much business for its capital investment. Such a concern needs either to retrench its activities or else increase its capital investment. It is, therefore, advisable to analyze and appraise this ratio in connection with the proportion of Worth to Debt, for a high Sales to Worth ratio is apt to be accompanied by a low ratio of Worth to Debt, an extreme approaching the danger point of credit.

More frequently, businesses lacking progressive managements do not keep the funds actively employed. If this rate of activity is below normal or falling, it indicates a condition of "dry rot," where the investment is moving too slowly and sluggishly and the funds are not sufficiently productive. It is a symptom either of overcapitalization or of the approach of a natural death of stagnation.

Insurance to Merchandise.—That the question of fire insurance is very important in considering a credit risk is evidenced by the untiring activity of the Insurance and Fire Prevention Committee of the National Association of Credit Men. Among other functions this committee has as its important duty to devise methods whereby debtors may be induced to carry adequate insurance against fire losses. A concern selling goods on credit to a merchant who is not protected against fire is assuming a double risk; the ordinary risk incident to credit granting, and the risk of loss from fire. Furthermore, neglect to protect himself against fire losses frequently indicates to the creditor that the merchant's business methods, in general, are more or less loose. If the stock is properly insured in case of fire, the merchant will not only have enough for the payment of his obligation, but will also be able to start anew.

To produce this ratio, divide the value of the policy by the average merchandise kept on hand, or by the inventory shown in the statement. In event the proportion of insurance to merchandise is low, the inference may reasonably be drawn that the mer-

chant is too careless and is not sufficiently protected or that the merchandise inventory has been overstated. The nearer this ratio is to 100 per cent, or 1 to 1, the more favorable it is, and *vice versa.*

In this connection, creditors should bear in mind the 80 per cent coinsurance clause. The purpose of this clause is to induce policy holders to carry insurance to nearly full value of the property insured. The effect of this clause may be illustrated as follows:

	Value of Property	Face of Policy	Fire Loss	Liability of Insurer
Case I.....	$10,000	$8,000	$6,000	$6,000
	10,000	8,000	8,000	8,000
	10,000	8,000	9,000	8,000
Case II... ..	10,000	7,000	8,000	7,000
Case III.....	10,000	7,000	5,000	Insurance company pays 7/8, or $4,375, and insured bears 1/8 of loss, or $625.

In Case I, the insurance company indemnifies the assured for the actual loss sustained up to the face value of the policy, because the amount of insurance carried equals 80 per cent of the value of the property covered. The 80 per cent clause has no effect upon Case II, because the *loss* equaled 80 per cent. Under such circumstances the assured recovers up to the amount of the policy. In Case III, however, where both insurance and fire loss are below 80 per cent of the value, the coinsurance clause becomes operative. The assured then stands his ratio of loss as demonstrated above. Similarly, if only $6,000 insurance is carried on property valued at $10,000, the company indemnifies for six-eighths of the actual loss sustained and the assured bears the remaining two-eighths.

A more recent development along this line is to insure the lives of officers of a corporation, members of a partnership, or even the life of a single proprietor. Business insurance is generally recognized today as a secondary factor to be taken into consideration in the extension of credit. Its importance for credit purposes, to be sure, varies greatly with the particular situation involved and the nature of the business. Where the success or failure depends largely upon the brains and guiding genius of one individual, it becomes almost essential that an insurance policy on his life, in favor of the company, be obtained, if the

concern's commercial paper as well as general credit condition is to be strengthened. This dominating individual of a so-called "one-man organization" is not necessarily the president of the corporation, but may be another important official of high executive talent, selling or engineering ability, or one whose personality is responsible for the good will that the company enjoys. He is the key man, whose death means a permanent or at least a temporary setback. Under such circumstances it stands to reason that, although business insurance will probably fail to restore credit where it is seriously damaged, it is nevertheless of sufficient importance to warrant its being considered as one of the factors to be taken into account in judging the credit risk.

Operating Ratio.—To develop this ratio, divide net sales or gross income by total operating expenses. Thus, if the sales are $100,000 and the operating expense $40,000, the operating ratio may be expressed as 2.5 to 1, or 5 to 2. It means that it costs on an average $1 to sell $2.50 worth of goods, or $2 to sell $5 worth of merchandise. This ratio serves as an index to relative business efficiency by comparing it with those of other companies engaged in the same line of trade, or by comparing it with a normal established for the line in question.

A decline in the operating ratio normally indicates improvement in the management of the business. However, such a decrease may have been caused, not by an increased rate of turnover, but by some temporary and doubtful economies that may be practiced, such as failure to provide adequate reserves for depreciation, bad debts, and the like. These economies, although immediately resulting in a lower operating ratio, are obviously detrimental in the long run of events.

Earnings to Investment.—This ratio is found by dividing the annual net profit by the owners' equity. It indicates the general profitability of the enterprise. A high ratio may mean one of two things, namely, that profits are high, or that the business is financed primarily through the issue of bonds and so-called short-time notes. When the ratio is falling, the company is obviously retrograding.

Probably a better measure of the earning power of a business enterprise is the ratio of net earnings to *total capital* investment. This ratio shows the net results realized from the various operations of the concern and the full amount of capital employed therefor. To establish this ratio, the total capital as represented

A Company

Assets			Liabilities	
Cash		$ 4,916.34	Notes Payable to Banks	$ 151,721.51
Notes Receivable		1,844.16	Trade Acceptances Payable	39,321.92
Accounts Receivable	$195,131.31		Accounts Payable Not Due	172,892.02
Less Reserve for Doubtful Accounts	6,186.67	189,944.64	Accrued Items Payable	12,304.97
Merchandise Inventory		320,954.93		
Government Securities		750.00		
Total Current Assets		$ 517,410.07	Total Current Liabilities	$ 376,240.42
Land	$ 27,454.46		Preferred Stock	$1,000,000.00
Buildings	296,376.29		Common Stock	250,000.00
Machinery, Equipment and Fixtures	293,134.16		Deficit (Red)	*68,993.29*
	$616,964.91			
Less Reserve for Depreciation	25,487.09	591,477.82		
Railroad claims		453.29		
Prepayments		72,905.95		
Good Will, Patents, and Trade-marks		375,000.00		
Total Assets		$1,557,247.13	Total Liabilities and Proprietorship	$1,557,247.13

Sales $1,454,724.

B Company

Assets			Liabilities	
Cash		$ 22,382.43	Accounts Payable Not Due	$ 42,062.23
Notes Receivable		16,502.64	Accrued Wages	11,997.47
Accounts Receivable	$138,171.87		Dividends Payable	4,431.00
Less Reserve for Doubtful Accounts	20,000.00	118,171.87	Reserve for Taxes	10,440.20
Raw Material		49,391.21		
Goods Finished and in Process		54,797.05		
Certificate of Deposit		60,000.00		
Total Current Assets		$321,245.20	Total Current Liabilities	$ 68,930.90
Land		10,500.00	Reserve for Depreciation of Buildings, Machinery and Equipment	76,960.33
Buildings		75,436.04	Preferred Stock	213,200.00
Machinery, Equipment and Fixtures		100,167.45	Common Stock	147,700.00
Deferred Charges		13,140.27		
Good Will, Patents and Trade-marks		35,000.00	Surplus	48,697.73
Total Assets		$555,488.96	Total Liabilities and Proprietorship	$555,488.96
Sales	$609,378.57			
Net Earnings	32,582.63			

C Company

Assets			Liabilities	
Cash		$ 1,853.98	Notes Payable to Banks	$ 8,000.00
Accounts Receivable	$11,803.65		Accounts Payable Not Due	4,710.66
Less Reserve for Doubtful Accounts	266.74	11,536.91	Accrued Wages	96.01
Merchandise Inventory		20,368.00		
Total Current Assets		$33,758.89	Total Current Liabilities	$12,806.67
Machinery, Equipment and Fixtures	$ 7,468.70		Common Stock	20,000.00
Less Reserve for Depreciation	2,141.50	5,327.20	Surplus	8,253.90
Accounts Receivable from Others		690.37		
Patents, etc		1,284.11		
Total Assets		$41,060.57		$41,060.57
Sales	$97,954.60			
Net Earnings	4,592.73			

by the sum of the firm's assets should be divided into the net profits for the year under consideration.

Statement Analysis Illustrated.—In order clearly to comprehend the theory and application of the process of statement analysis, three statements representing companies of varying size but engaged in the same line of trade will be analyzed. These statements are shown above.

Without attempting in any way to "shade" the assets, except that the intangibles including good will, patents, and trade-marks are disregarded, the following figures combining into the different relationships are arrived at. The intangible assets are naturally deducted from the total net worth so as to arrive at the real value of the item.

	A Company	B Company	C Company
Current Assets	$ 517,410	$321,245	$33,758
Current Liabilities	376,240	68,930	12,806
Merchandise Inventory	320,954	104,188	20,368
Receivables	190,788	134,673	11,536
Fixed Assets	664,835	122,283	6,017
Net Worth	816,007	374,597	26,969
Total Debt	376,240	68,930	12,806
Net Sales	1,454,724	609,378	97,954
Net Earnings	*93,800* (Loss)	32,582	4,592

From these figures the respective ratios are calculated as follows:

	A Company	B Company	C Company
Current Ratio = Current Assets / Current Liabilities	517,410 / 376,240 = 1.4:1	321,245 / 68,930 = 4.6:1	33,758 / 12,806 = 2.7:1
Worth to Fixed Assets = Net Worth / Fixed Assets	816,007 / 664,835 = 1.2:1	374,597 / 122,283 = 3.1:1	26,969 / 6,017 = 4.5:1
Sales to Receivables = Net Sales / Receivables	1,454,724 / 190,788 = 7.6:1	609,378 / 134,673 = 4.5:1	97,954 / 11,536 = 8.5:1
Sales to Merchandise = Net Sales / Merchandise Inventory	1,454,724 / 320,954 = 4.5:1	609,378 / 104,188 = 5.8:1	97,954 / 20,368 = 4.8:1
Worth to Debt = Net Worth / Total Debt	816,007 / 376,240 = 2.2:1	374,597 / 68,930 = 5.4:1	26,969 / 12,806 = 2.1:1
Sales to Fixed Assets = Net Sales / Fixed Assets	1,454,724 / 664,835 = 2.2:1	609,378 / 122,283 = 4.9:1	97,954 / 6,017 = 16.3:1
Sales to Worth = Net Sales / Net Worth	1,454,724 / 816,007 = 1.8:1	609,378 / 374,597 = 1.7:1	97,954 / 26,969 = 3.7:1
Earnings to Investment = Net Earnings / Capital Investment	Loss	32,582 / 360,900 = 9.0%	4,592 / 20,000 = 22.0%

From the foregoing it is apparent that the credit manager is justified in arriving at the following conclusions regarding these three respective companies:

A Company.—1. That the current ratio is altogether too low considering the normal for the trade in question, so that the least shrinkage in the current assets will seriously jeopardize its ability to meet current obligations.

2. That, because of the fact that most of the machinery in this trade is obtained on a royalty basis, the ratio of Worth to Fixed Assets should be considerably higher than shown in this statement, probably no less than 3 to 1.

3. That, when viewed in connection with the ratio of Sales to Fixed Assets, the Worth to Fixed Assets proportion discloses a strong tendency toward overexpansion. Being an industry in which fixed assets owned constitute a small proportion of the total capital investment, it is quite evident that both of these ratios should be relatively high, the normal in the trade for the former being somewhat over 5 to 1. Obviously, the plant is

enlarging more rapidly than worth and its sales productivity does not at the same time justify such extension of fixed properties.

4. That the liquidity and freshness of its receivables is about normal, as evidenced by the Sales to Receivables ratio of 7.6 to 1, meaning thereby that the annual sales exceed the outstandings by 6.6 times. Putting it in another way, it means that the outstandings carried on the books approximate 48 days' sales. Since the terms in the trade are 30 to 60 days, respectively, this ratio approaches the standard.

5. That its buying policy as disclosed by its Sales to Merchandise ratio, which shows the rate of stock turnover, is also more or less normal.

6. That the Worth to Debt ratio, particularly when viewed in the light of the Worth to Fixed Assets proportion, reveals a situation in which the company is relying too greatly upon its creditors' decisions for working capital, and constitutes, therefore, primarily a moral risk.

7. That, because of its low Current ratio, policy of overexpansion, and high degree of dependability upon its creditors to supply working capital, the risk is primarily one of moral character, and in event little belief is had in the moral aspect of the risk, no credit whatever should be extended under these circumstances.

B Company.—1. Although the Current ratio greatly exceeds the standard, its importance is substantially diminished by the size of outstandings as revealed in the ratio of Sales to Receivables. This shows that no less than 81 days' sales are carried on the books, which is nearly twice the amount that should remain outstanding under the terms prevailing in the trade. This conclusion is further strengthened by the enormous percentage that has already been written off as a reserve for doubtful accounts. It means that the merchant is granting credit too liberally or else is a poor collector, or both.

2. That the company does not rely much upon its creditors as a source of supply of working capital, since for every dollar it borrows it has $5.40 of its own invested in the business, and, similarly, for every dollar invested in fixed properties it has $2.10 invested in current assets.

3. That, in view of the foregoing, the company is entitled to credit accommodations. However, it is advisable, before ex-

tending a large line of credit, to influence the management to revise and strengthen its credit and collection policies, for these constitute its weakest points.

C Company.—1. That this company is in a favorable position from the standpoint of the Current ratio is entirely undisputed. The nearly 3-to-1 ratio may be taken at par, because of the freshness and liquidity of its receivables and the salability of its merchandise inventory. From the Sales to Receivables ratio it is to be noted that the outstandings are collectible on the average 8.5 times per annum, or that the outstandings carried on the books constitute only 43 days' sales, which under 30- and 60-day terms is highly favorable.

2. That, although the Worth to Fixed Assets shows up favorably, the company is nevertheless relying too greatly upon its creditors to supply its working capital, probably because it is overextending its operations, as indicated by the ratios of Sales to Fixed Assets, and Sales to Worth, respectively. The conclusion is, therefore, that although a large amount is invested in the "going part" of the business, in proportion to that invested in fixed assets, the proportion of this investment is relatively small in comparison with the total amount required for its working capital under normal business activity.

3. That, because of the foregoing conclusion, the company is entitled to credit, provided it agrees to pursue a policy of reinvesting its earnings in the business, or else to supply additional capital through the sale of either stocks or bonds, preferably stocks.

Value of Comparative Statement Analysis.—The analysis of a concern's financial responsibility from one statement gives the credit manager an insight into the condition of the business at a given moment—at the time the statement was prepared. The business is inspected and scrutinized, as it were, when at a standstill. To keep the finger on the pulse of progress when the concern is in a dynamic state, these analyses should be compared over an extended period of time. Much valuable information can thus be disclosed by comparing the essential items at different dates and by noting changes in ratios at these intervals. From such comparisons the credit manager can thus accurately determine whether the subject's business is improving, standing still, or retrograding.

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CHAPTER XVI

SOURCES OF RETAIL CREDIT INFORMATION

Besides the personal interview, which is given due consideration elsewhere, there are three sources of information available to the retail credit grantor. They are: banks, credit reporting agencies, and cooperative interchange bureaus.

BANKS

Banks as a Source of Information.—Although the banker's work lies in the province of financial transactions only, he is nevertheless, in a sense, classed as a retail credit grantor. He operates on the basis of the principles laid down for retail credit grantors every time he extends a loan on an unsecured note, with chief reliance on the borrower's financial and moral responsibility. Hence, the interest of the banker in the manner in which his borrowing accounts meet their obligations elsewhere. In order to obtain the required data from retailers, bankers find it necessary to reciprocate.

Methods of Securing Information from Banks.—Information from banks may be obtained by retail merchants by one of three methods in use: by telephone or telegram, by messenger, or by mail.

Telephone inquiries are at best unsatisfactory, as judged by results obtained. This method usually involves a serious waste of time, due to the necessity for confirming the inquiry, unless the inquirer's voice is recognized by the person answering the telephone at the bank. In order to insure that the proper person obtains the information, both parties hang up the receiver and connections are reversed. Because of this, it is recommended that telephone inquiries be used sparingly and with a view of obtaining data which can be given with little delay. To secure data from out-of-town banks, inquiries are occasionally made by telegram.

It is customary for large stores in many cities to make inquiries by messengers or runners. These investigators make

regularly scheduled trips to the banks from which data are sought. All special cases requiring immediate consideration are looked up at once. All other names on which information is desired are listed alphabetically and handed to the bank's reference clerk, whose function it is to furnish the data on names on file and have the replies ready when the messenger makes his next trip. Obviously, the better qualified the investigator, the higher the quality of information which he is likely to secure, and *vice versa*.

Inquiries by mail should be reserved for emergencies, or cases where more detailed information of a highly confidential nature is desired. The right sort of an inquiry personally directed to an officer of the bank and signed by the credit manager ordinarily brings the right sort of reply, showing the size of average bank balance, whether the prospective customer honors his notes when due, whether he overdraws his account, or makes unjust claims respecting his balances, and the like.

CREDIT REPORTING AGENCIES

Almost every city of any size has one or more credit reporting agencies, frequently referred to as Bureaus of Credits or Merchants' Credit Rating Companies.

Functions.—The chief function of these organizations, aside from collecting doubtful and bad accounts, is to publish rating books. These books are not sold, but leased to subscribers. They are to be used as confidential information, in accordance with a written agreement entered into between the subscriber and the agency. Rating books are issued by some agencies semi-annually, by others annually, and in many instances biannually. They contain the actual experiences of the merchants operating within the territory covered by the respective organizations.

Rating books usually contain the following information: the name, occupation, and residence of the individual rated, and his rating or inclination to meet his obligations with promptness. Ratings are expressed by symbols and intend to indicate whether or not the person under consideration is entitled to credit accommodations. Thus P may indicate prompt-pay, S slow-pay but good risk, and another type of symbol, say X, may indicate a poor risk or one that cannot be recommended for credit. It is also customary to indicate the number of merchants effectively

consulted concerning any given name appearing in the book. For example, X4 would show that the individual cannot be recommended for credit by four merchants. Again, P6 S3 means that the individual is reported as prompt-pay by six merchants and three merchants reported him as slow-pay. The rule ordinarily followed is to extend credit rather freely when prompt-pay predominates and to require cash or security when one or both of the other ratings predominate. It may be observed in this connection that, where names have carried several good reports and only one unfavorable, the latter is not published, but placed in the file record at the office and is published only in case an additional unfavorable report is received at a later date.

Another feature of the rating books is to include a list of pay days established by the different industrial and mercantile institutions in the community, so that, in arranging dates of payment, retail credit grantors will so fix them as to coincide as nearly as possible with the dates when income is received.

Rating books usually contain the names of current buyers on credit only. They do not as a rule include names of transients, minors residing with parents, cash buyers, and persons concerning whom information is limited or conflicting.

Another function of these agencies is to issue bulletins periodically, usually monthly or bimonthly, containing changes in ratings; names and addresses of newcomers and newlyweds; suits for debts as taken from court records; bankruptcies, voluntary and involuntary; new incorporations; changes in address; building permits; legal notices to the effect that the notifying persons will not be responsible for any debts contracted by anyone other than themselves; and other similar items of interest to retail credit grantors. When rating books are published infrequently, ample space is provided in them for entering new names, changes, and corrections as they appear in the bulletins from time to time.

A third function of credit reporting agencies is to furnish financial statements on application of subscribers and to render other reports about names which do not appear in the books, but whose records are on file at the office.

RETAIL CREDIT INTERCHANGE BUREAUS

Rise and Growth of Retail Credit Bureaus.—Prior to 1900, retail credit interchange bureaus, variously referred to as

"retailers' cooperative credit and collection bureaus," "retail credit exchange offices," "merchants' protective associations," reference clearance bureaus, etc., were practically unknown in the conduct of a retail credit business. The Denver Retail Credit Men's Association, for example, one of the pioneer organizations of its kind, was established as late as 1898 by an exceedingly small group of merchants who recognized the need for reliable credit information.[1] Previous to the establishment of these organizations, when an application for credit was made, the retail credit grantor was governed in his decisions principally by his own personal knowledge or outward appearance of the applicant. To be sure, some data were made available at the time by privately owned and privately operated companies who collected such information as was within their reach, published rating books containing opinions of consumers' credit standing, and issued special reports upon request. This information, however, was, as a rule, exceedingly meager and in many instances vague and out-of-date.

Prior to the twentieth century, communities were considerably smaller, consumers were better known, strangers rarely approached a merchant with a request for credit, and the bulk of retail business was conducted on a cash basis. The custom of trading in one place further aided in the effective maintenance of direct and personal contact between merchants and patrons. Under these circumstances, the granting of credit on the basis of the meager information then available might have been satisfactory for the most part. But conditions have changed to such an extent as to necessitate the development of a more scientific method for the basis of extending credit accommodations to consumers. Towns and cities have grown to enormous dimensions, the population is constantly shifting, credit is asked for more freely, even by strangers, customers have formed a habit of trading in more than one store engaged in a single line of business, and the size of retail establishments and their corresponding clienteles have increased manifold.

Because of these changed conditions, it was obviously impractical as well as disastrous for a merchant to rely merely upon his personal knowledge as a basis for decisions respecting the numerous prospective customers who applied for credit. Conse-

[1] O'Brien, John C., "How Denver Retailers Handle Credits," *The National Retail Clothier*, Aug. 3, 1922, p. 60.

quently, the merchant was put to much trouble in seeking information about other charge accounts which prospective patrons mentioned to him when opening the account. The difficulties were further accentuated by the fact that applicants failed to list all of the stores in which charge accounts were maintained. Hence, the merchant had no means of knowing where the prospective patron had charge accounts other than those establishments to which reference was made by him and it was, therefore, difficult to ascertain the aggregate indebtedness. Moreover, they generally confined their references to stores where the account was in good standing. Frequently, accounts had to be closed by some stores because of slow pay or otherwise unsatisfactory dealings, by collecting it through an attorney or collection agency, or by charging it to the reserve for doubtful accounts and thence to profit and loss. If such data had been readily obtainable, retail merchants would have been saved considerable sums by refusing such risks when applying for credit.

In order to obviate the difficulties encountered in seeking complete and pertinent data concerning applicants for credit as well as accounts already on the books, the establishment of a central bureau becomes essential. For this reason there is hardly a city of any size in the United States without a central bureau for the collection and dissemination of relevant data concerning individuals seeking to open charge accounts.

Organization.—Practically all retail clearance bureaus are merchant-owned, merchant-controlled, and merchant-operated. Most of them are strictly cooperative, non-profit, mutual benefit associations, operated solely for the convenience and protection of their members. A notable exception to this is the Cleveland Retail Men's Credit Company, Cleveland, Ohio, which is nominally a stock corporation in which the officers of the company are selected annually, not by subscribers as such, but by stockholders. All of the officers thus selected, as well as the stockholders, are representatives of local retail establishments. The actual conduct of the business in all of the bureaus is entrusted to a salaried official designated as "manager" or "executive secretary," who is elected annually by the board of directors. The relations of the members one to another and to the organization are governed by by-laws and the contract entered into when a member joins the association. The contract usually

outlines the means by which the member is expected to cooperate with the bureau and lists the services the association purports to render the member.

Purpose of Retail Credit Bureaus.—The chief aim of these organizations, not unlike that of the credit interchange system of the National Association of Credit Men, is:

1. To provide an impartial medium between debtors and creditors and between creditors themselves.

2. To establish a system whereby those who are interested in any accounts may freely and unreservedly interchange the facts contained in their ledgers without the necessity of direct reference, each to the other, and without divulging their information under their own name.

3. At all times to receive in exchange for items contributed by them the combined experience of all the others interested in the account.

4. To relieve the individual concerns of the necessity of furnishing the same information over and over again in different forms to different houses requesting it, for one of the requirements of membership in many instances is absolutely to refuse to furnish ledger facts, except through the central bureau.

Method of Operation.—The feature which characterizes retail credit bureaus is that they depend for their success and efficiency upon the closest cooperation of their member stores; laxity and carelessness on the part of any member of the organization in the discharge of obligations lessens to that extent the efficiency of the entire system. Hence, it is insisted when a retail merchant enrolls in the organization that he agree to furnish the association with information as may be required from time to time.

One of the first requirements of new members is that they register immediately with the bureau all their charge accounts on slips or forms provided for the purpose. The information included in these forms consists of the name; residence; former residence; occupation; business address; date account was opened; highest amount of credit extended; amount owed; paying habits; whether the account is active or inactive, satisfactory or unsatisfactory; and general remarks.

Thereafter member stores are required to report new accounts to the bureau if not cleared through it, as rapidly as they are opened. Stores in which new accounts are added daily are

asked to report them daily. Many bureaus require that members furnish daily duplicates of the application forms of new

Limit $ _____ Date _____

Retail Merchants Association

Credit Application

Name _____
Give name in full — Telephone

Address _____
How long?

Former Address _____
How long?

Do You Live at Home? Parents' Name _____

Business or Occupation _____
Telephone

Employed by _____
How long?

Bank _____

Property Claimed _____

In Whose Name _____

Value _____ Mortgage _____

Reference _____

Reference _____

Reference _____

Remarks _____

In consideration of credit to be extended to me or members of my family, I hereby agree to pay accounts according to your terms of 30 days.

Signed _____

Form 242

FIG. 30.—Credit application required by retail stores.

applicants, together with a statement of whether the account was opened or refused, and, if refused, the reason therefor. A

convenient application form provided for this purpose by the association is presented below (see Fig. 30).

Members further agree to report immediately when an account is closed and the reason therefor. They must also furnish all kinds of derogatory information, such as accounts turned over for collection to an attorney or agency, or bad checks received, and the like.

Some bureaus also require their members to report daily all inquiries for credit information which they give to non-members. In all instances they are to furnish the organization with any information pertaining to the credit standing of patrons, as may be required from time to time, including changes of addresses, changes in ratings, and so on.

In addition to retail dealers in all sorts of commodities, some of the larger bureaus serve dentists, physicians, automobile companies, banks, hotels, mortgage companies, etc.

Where many different lines of business are represented by the members of a bureau, each line of trade is represented by a series of consecutive numbers, and each member in a given group is designated by an individual number. Thus, for example, shoe dealers would have numbers 1 to 50, stationers, 50 to 100, wall paper dealers and decorators, 100 to 150, department stores, 150 to 175, and so on. Any individual shoe dealer would then be given a number somewhere between 1 and 50, depending upon the number of dealers already carried as members in this group at the time of enrolment. Similarly, a department store would be assigned a number somewhere between 150 and 175.

In the office of the bureau there are thousands of cards technically termed "master cards," bearing the names of people who have asked for credit from local and out-of-town merchants. Such a master card is made out for each individual about whom information is available at the office. The Cleveland Bureau is said to have master cards for over 600,000 individuals, whereas the Denver Retail Credit Men's Association Bureau has accumulated in the quarter century of its existence the credit history of more than 200,000 persons. The contents of these cards vary with different bureaus. Usually, however, master cards provide space for the name of the individual; his address; former address; business address; date of the information recorded; the numbers by which reporting subscribers are identified; amount of credit extended; and rating assigned (see Fig. 31).

In addition to the files containing master cards, some of the larger bureaus maintain a set of special files, containing special information concerning certain names on record, which may have considerable bearing in determining whether to accept or refuse an applicant for credit. Occasionally, the master cards take the form of a folder or an envelope, thus obviating the necessity of maintaining separate files for special information.

The master card files are so divided that any desired card may be found without the least delay. Since much and in smaller bureaus practically all of the information is dissemi-

Name

Address Former Ad.

Business Ad.

Date	No.	Time	Amt.	Why	Date	No.	Time	Amt.	Why	Date	No.	Time	Amt.	Why

FIG. 31.—Retail credit bureau master card.

nated to members over the telephone, many direct lines connect the office with the larger member stores, and a corps of telephone operators, each of whom has charge of a certain part of the alphabet, such as from A to E, F to L, etc., are constantly answering inquiries. In addition to the telephone service, many bureaus have a messenger service by means of which reports are sent out several times a day.

Each day, the clerical force of the bureau adds to the master cards on file any additional information that comes in from members concerning bad or short checks, accounts closed, and accounts reopened and reasons therefor. In this manner each patron's record is kept up-to-the-minute.

To illustrate the method of operation of a typical bureau, we might cite a complete transaction. Suppose a customer X applies for credit from one of the members of the association. The credit manager of the store from which credit is sought has him fill out a credit application form. This form is designed to give a statement of the applicant's residence and occupation for several years past. It also reveals his financial responsibility by showing whether he owns property and, if so, its value, encumbrances, and whether it stands in his name. When the application form is filled in and further information is deemed desirable, the credit manager or his assistant telephones the bureau, whereupon the operator, after consulting the master card file close at hand, reads all the information appearing thereon. If no record of the applicant is on file, the credit manager will have to act on the basis of the answers to the questions on the application form, or else delay opening or refusing the account until further data are procured, whereupon the bureau will proceed, at the request of the member affected, to investigate the risk. If the references given reside within the city, it is, of course, possible for the bureau to get in touch with them immediately, particularly when they represent business houses. If the references given represent merchants in other cities where the prospective customer formerly resided, these references are cleared by the bureau, which sends a letter to merchant-owned associations or directly to the out-of-town stores requesting that the proper data be filled in on a convenient form provided for the purpose (see Fig. 32).

Again, if the information on file appears to be old, usually over 60 days, attempts are made to gather the most recent ledger experience on the subject of inquiry by telephoning to all members whose codes appear on the master card. When the information is thus compiled at the request of a member, the clerk in charge of the branch or alphabetic section of the master card file in which the subject's name appears immediately phones the results of the investigation to the inquiring store.

In order that members (or subscribers, as in case of the Cleveland office) may translate the information contained in the reports and bulletins issued by the bureaus, a confidential code or key is furnished each member. These codes vary considerably with the different bureaus, both as to the scope and

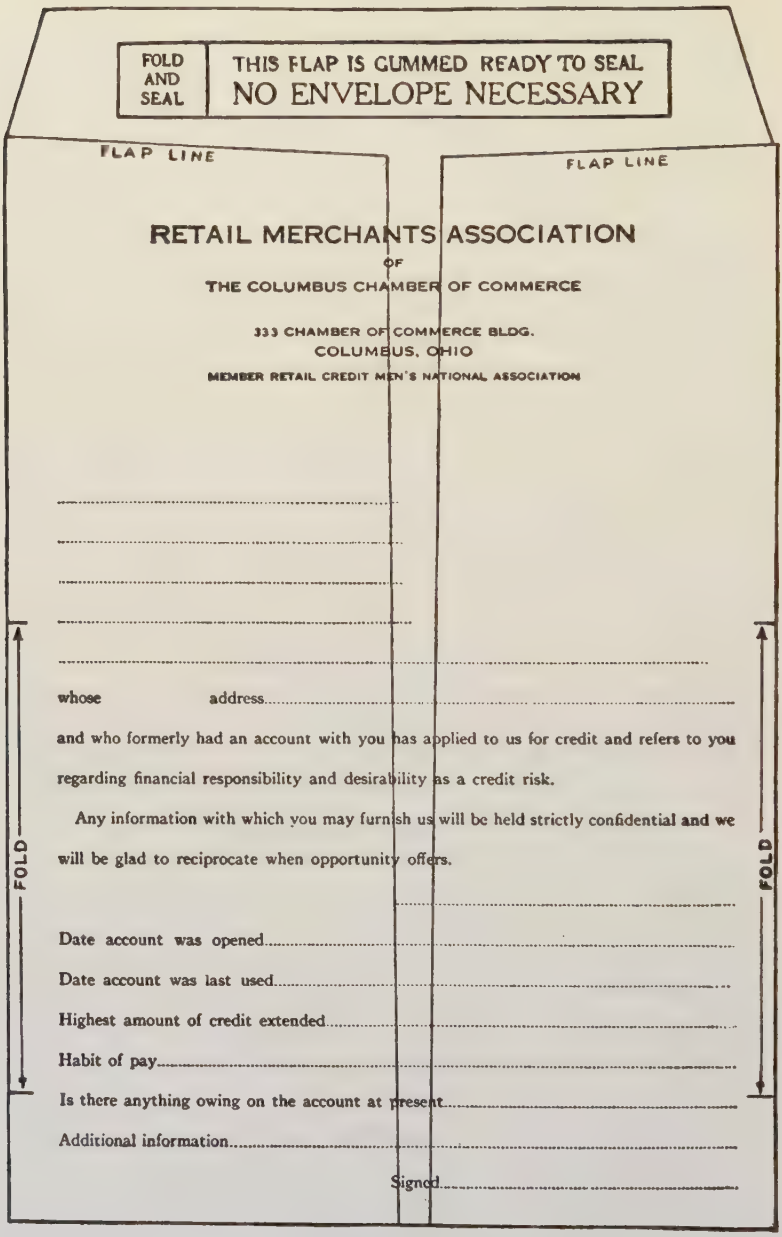
FOLD AND SEAL
THIS FLAP IS GUMMED READY TO SEAL
NO ENVELOPE NECESSARY
FLAP LINE
FLAP LINE
RETAIL MERCHANTS ASSOCIATION
OF
THE COLUMBUS CHAMBER OF COMMERCE
333 CHAMBER OF COMMERCE BLDG.
COLUMBUS, OHIO
MEMBER RETAIL CREDIT MEN'S NATIONAL ASSOCIATION
whose address
and who formerly had an account with you has applied to us for credit and refers to you regarding financial responsibility and desirability as a credit risk.
Any information with which you may furnish us will be held strictly confidential and we will be glad to reciprocate when opportunity offers.
Date account was opened
Date account was last used
Highest amount of credit extended
Habit of pay
Is there anything owing on the account at present
Additional information
Signed
FOLD
FOLD

FIG. 32.—Form used by the bureau for securing information from out-of-town references.

method. The following is a key devised by a number of bureaus, relating to payment schedules, checks, and special information:

CODE KEY

Payment Schedule	
A	30 to 60 days
AA	As agreed
B	60 to 90 days
C	90 to 120 days
D	Slow but good
E	Enquire
F	Collection
G	Profit and Loss

Checks	
P	Protest
NSF	Returned, not sufficient funds
RNA	Returned, no account
RAC	Returned, account closed
RPS	Returned, payment stopped
RAA	Returned, account attached

Special Information	
ACR	Account closed, request
ACTS	Account closed, too slow
ACCC	Account closed, can't collect
CR	Chronic returner of goods
DB	Dead beat
DC	Don't charge
DPR	Declined past record
DSI	Declined special information
EU	Extremely unsatisfactory
ID	In debt
IR	Insufficient reference
L	Loan negotiated
LR	Loan rejected
NBC	No basis for credit
PD	Past due
PNK	Promises not kept
R	Rejected
REP	Repossession
RV	References unsatisfactory
U	Undesirable
UFC	Unfair claims
VS	Very slow
NR	Non-responsibility
FP	Fraud purchases on this account

Some bureaus have, in addition to what has been given, a code pertaining to the amount of credit, somewhat as follows: 1 represents \$10; 2, \$20; 3, \$30; etc.; x represents \$5; lx, \$15; 2x, \$25, etc. H represents \$100 to \$200; and HI \$200 and over.

FUNCTIONS OF RETAIL CREDIT BUREAUS

Reports on Applicants.—As already pointed out, the chief aim of these bureaus is to furnish information concerning applicants for credit and accounts already on the books upon request of members. Although the inquiries are answered by telephone, nevertheless written transcripts of a customer's record may be furnished by messengers who make the trips in accordance with a regular schedule several times a day.

Special Reports.—Bureaus furnish upon request special trade information, consisting of data regarding total indebtedness or other facts desired by the inquirer in addition to the regular

information recorded on the master card. Such information as contained in a special report is generally held in strict confidence.

Indebtedness or Clearance Report.—If knowledge is desired concerning a customer's buying activities and his aggregate indebtedness, the bureau is prepared to supply it. Upon receipt of a request for such a report, the bureau makes inquiry of each of the member stores known to sell the customer and a summary of the information thus procured is made in the form of an indebtedness report. Some bureaus make it a practice to furnish a copy of the report to each member interested in the subject. In case the consumer is found to buy unusually heavy on some accounts and to have overextended his credit, the merchants will take the proper action either through the bureau or through a committee, usually the former, sometimes calling for a liquidation of his debts before any further credit is to be extended by any merchant. A common method is for the bureau manager to call upon each interested member and, if agreeable to all concerned, the bureau manager or the largest creditor writes the customer a letter requesting an interview, when the facts are laid before him and a request is made for a statement of his financial responsibility, or for any other information which would tend to justify such large indebtedness. If the additional information is unsatisfactory, arrangements are then made for the payment of the account, which may be done through the association, in which case payments are distributed pro rata each time a certain sum is collected, or the customer may agree to pay each member proportionately until the account is again reduced to safe limits.

Derogatory Information.—The bureau keeps its members informed of happenings to an account in which they are interested. Thus, information concerning unusual activity in opening new accounts, buying unusually heavy on any one account, or when an impostor is buying on an account is automatically broadcast to all members interested. The bureau serves as a receiving station for all sorts of credit information. The organization usually has a working agreement with the post office department and sometimes the express companies whereby the names of forgers, passers of "bad paper," and other suspicious individuals are reported to the association. Again, reports pour into the office daily from members of short and bad checks received. As rapidly as this information is received by the

association, it is flashed by telephone to the stores likely to be interested in the names in question. The bureau also notifies the members daily, usually by telephone, of the names of individuals who were refused credit or whose accounts were closed by other members, and the reasons for such action. Other information which is generally considered detrimental or derogatory, and, consequently, passed on to members whose codes appear on the master card, consists of suits for debts, assignments, collection accounts, mortgages, and the like. Finally, the members of the association are notified of the presence of short or bad check artists in the city, as soon as their presence becomes known to the bureau.

Tracer Reports.—Upon request of a member, the bureau traces missing debtors and issues tracer reports, containing a summarized statement of the action taken and the results obtained.

Real Estate Reports.—A few bureaus furnish reports on real estate, compiled by special agents from real estate records in the county recorder's office. They contain the name of the subject about whom inquiry has been made, street, original lot, sublot, foot frontage, owned by, tax value, mortgage to, amount, date, second mortgage, mortgage to, amount, date, and additional comments of the reporter. The purpose of such report is to check on the statement made in the application form concerning properties owned by the applicant. Another way in which this information is made available by the association is by keeping a plat of all the additions and subdivisions of the city, together with the names of the owners of property. This record is kept up to date by rechecking daily with the real estate transfers as reported in the local legal journal.

Special Bulletins.—Special bulletins are issued to all members, monthly, semi-monthly, weekly, or at even more frequent intervals. All items of interest are contained therein, such as accounts of bad check passers operating in the city and other communities, information furnished by members regarding bad accounts on their books; notices of non-responsibility for debts given out by husbands; new firms; changes of address; names and accounts of counterfeiters of currency, traveler's checks, etc. Some bureaus do not issue bulletins at stated intervals, but put one out whenever there is something new or of special interest to the members at large. It is argued that, in the absence of

regular intervals at which bulletins are to be issued, more interest is displayed by members, for they know that whenever the bulletin does come out there is something of special interest.

Periodic Meetings.—Monthly or weekly meetings of members of the credit bureau are held for the discussion of credit problems and the interchange of credit information. At these meetings demonstrations are given of methods of opening and closing accounts, and discussions are entered into involving delinquent accounts, credit and collection policies, and similar matters. A common feature of these meetings is for the bureau secretary to read the names of individuals concerning whom information is desired by some one member present. Such names are usually turned in to the bureau some time in advance of the meeting. As the names are read, any member who has pertinent information respecting any of them signifies the fact by calling out his number and proceeding to supply it. All information at these meetings is usually given in code as indicated in the confidential code key described in the earlier part of this chapter.

Cooperation with Detective Agency.—Whenever possible, the association supplies information to the detective agency employed by the retail merchants so as to facilitate in apprehending shoplifters, who prey upon the big stores. In return, the detectives are frequently in a position to supply the association with useful information concerning individuals likely to approach merchant members for credit.

Collection Service.—Only a limited number of bureaus find it profitable and worth while to operate a collection department. Many of them, however, furnish two form letters which are sold to members. Each letter has a space at the top for inserting the delinquent's name and address, and space in the body for the name of the firm and amount due. These letters contain the bureau's letter heads and have an undoubted psychological advantage on the debtor's mind over letters sent directly by a single creditor. Because more elaborate treatment of this phase of credit work is reserved to another portion of the book, it will suffice to add here that the development of collection service by credit bureaus is largely an outgrowth of indebtedness reports which they are sometimes called upon to render. When the aggregate indebtedness is found to be excessive, merchants find

it convenient to entrust the collection of their accounts to the bureau, as already indicated in a previous connection.

Cost of Service.—Obviously, the cost of the service rendered by retail credit bureaus varies with the different organizations, their membership, and with the number of reports requested. Practically all bureaus charge a regular annual fee, which entitles the member to all the services of the organization and a minimum number of inquiries for investigations of customers' records. This fee varies from $10 to as high as $200 and over. Normally, however, it is about $30. The St. Louis Retail Credit Bureau, with a membership of close to 700 merchants, has an annual membership fee of $20, which applies to individuals and firms alike. The practice of this bureau is to apply only $5 of the annual minimum fee as membership fee, the remaining $15 being credited to the subscriber's account for service at the scheduled rates. These are as follows: 30 cents for each trade report, transmitted by telephone or messenger; 75 cents for each special written report; and 75 cents for each bureau tracer report.[2]

A schedule of charges somewhat different from the one just described is that employed by the Denver Retail Credit Men's Association, with more than 300 members representing various lines of trade. The regular annual fee for members is $30. Each member is entitled to all the services of the organization, including 100 credit reports. For inquiries in excess of 100, an additional charge is made of 25 cents each.[3] Again, the Cleveland Retail Men's Credit Company, with a membership of over 700, charges an initial fee of $20 a year to merchants operating on a small scale and most professional men, and $30 a year to all others. Charges for reports above the minimum are at the following rates: 30 cents for each trade report; $1 for each special report; 75 cents for a real estate report; and $1 for a clearance report.[4]

Advantages of Retail Credit Bureaus.—The importance of these bureaus and their advantages to the members may be

[2] STODDARD, W. B., "How St. Louis Controls Retail Credits," *The National Retail Clothier*, Sept. 20, 1923, pp. 57, 59.

[3] O'BRIEN, JOHN C., "How Denver Retailers Handle Credits," *The National Retail Clothier*, Aug. 3, 1922, pp. 60, 63.

[4] STODDARD, W. B., "How Cleveland Retailers Guard Against Credit Losses," *The National Retail Clothier*, Nov. 2, 1922, pp. 72, 74.

summed up in the following statement made by a writer on the subject:

> The . . . bureau is to the retail credit grantor what the clearing house is to the banks. It is a pivot around which retail credit business may circulate with reasonable safety; it is a clinic for the chronic credit abuser; it is the pulse of the retail charge business. It is a beacon light on an uncharted sea; a nucleus for a credit men's organization and for the promotion of a credit man's welfare. It is an educational center for disseminating among the public such propaganda as will aid a credit man's work.

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Walter, F. W.: "The Retail Charge Account," Appendix.

CHAPTER XVII

FOREIGN CREDIT INFORMATION

Nature of Information Sought.—As in domestic credits, a foreign credit manager seeks all the specific and detailed information concerning a customer's antecedents, manner of payment, character, and ability to succeed. Here, as elsewhere, a complete knowledge of all the facts regarding the applicant is essential to a correct credit decision.

One of the ways of judging a foreign merchant's character and ability is by the length of time he has been engaged in business. Past performance is probably the best indicator of the manner in which he will act in the future. If he has been in active operation for a long time and possesses a record of honest and profitable management, no sane credit manager would refuse credit accommodations. Similarly, the longer the business career of the prospective customer, the greater the opportunity for the credit manager to ascertain any unfavorable conduct on his part. On the other hand, concerns with a limited business experience have little to recommend them as desirable credit risks, even though the management is honest. Although they may prove their merits and superiority over older concerns, both in character and ability to operate their businesses, nevertheless, until such proof is presented in an overwhelming quantity, a credit manager will do well to give preference to those concerns which possess a record of continuous operation over an extended period of time.

A foreign merchant's buying activities and manner of payment constitute another important test of his credit responsibility. Merchants who buy within conservative limits and anticipate or pay their bills promptly are always preferred customers, probably on the assumption that these practices will continue. This does not mean that only those customers who have continuously and consistently met their obligations with great promptness are the superior risks. As a matter of practice, many of those whose records indicate that payments have been

occasionally deferred may also properly belong in this class, provided, of course, that they fully intended to discharge their obligations promptly but were prevented from following their inclinations because of certain extenuating circumstances beyond their control.

An insurmountable difficulty, at least for the present, is the lack of adequate accurate information obtainable regarding a foreign merchant's buying activities. It is well-nigh impossible, in many instances, to ascertain the extent of the obligations which have been contracted by the applicant. This is because of the lack of international offices or bureaus through which ledger experiences may be cleared effectively. As will be shown in the following pages, the service which is rendered by bureaus and agencies in this country is limited to the experiences of our exporters with the particular foreign accounts concerning which ledger information is sought. But these foreign merchants may also have bought substantial bills of goods in other lands, where their dealings may be decidedly unsatisfactory and reflecting seriously upon their credit and financial responsibility. There is no way as yet, however, in which this information can be secured in as reliable a fashion as that obtained in this country.

SOURCES OF INFORMATION

Classes of Information.—All sources of credit information regarding foreign buyers may be divided into two main classes. One class consists of all sources available in this country, and the other comprises the various sources located abroad, particularly in the locality of the prospective customer. The former includes mercantile agencies, credit bureaus maintained by associations, credit service organizations, American exporters selling the same trade, banks, and publishing companies. The latter consists of foreign agencies, foreign banks, American representatives, and the prospective buyer himself.

Domestic Sources

Mercantile Agencies.—Both Dun's and Bradstreet's, the two largest and the only general mercantile agencies in the United States, maintain offices in foreign countries in order to serve our exporters as well as the merchants and bankers whose operations are confined within the limits of this country. R. G. Dun & Company maintains a total of 79 offices in countries outside of

the United States. Of these, 17 are in Canada, 9 in Australasia, and the remainder in Mexico, Cuba, Porto Rico, South America, England, Scotland, Ireland, Holland, Belgium, France, Spain, Portugal, Switzerland, Italy, and South Africa. In places where no branch offices are located, the field is covered by traveling reporters or correspondents. In some countries, as in Germany, Austria, etc., the agency has an agreement with similar domestic agencies through which all information concerning risks located therein may be secured. Similarly, the Bradstreet agency and its subsidiaries maintain no less than 33 branch offices in foreign countries. Of these, 15 are located in Canada; 9 in Great Britain and Ireland, and the remainder in Newfoundland, Mexico, Cuba, Australia, France, and Belgium.

Both of these companies have accumulated a vast mass of foreign credit information and are, therefore, in a position to render valuable services to export credit managers.

Contents of Reports.—The information which these agencies furnish is usually in the nature of antecedents. The reports generally contain a complete historical sketch of the enterprise and the personnel. They give the date of establishment; type or form of enterprise; age, reputation, and experiences of the personnel; relationship or kinship of the respective owners and managers; and the progress made since the formation of the business. Following the section on antecedents a financial statement is presented, in case one is available. This is followed by general remarks, in which the figures contained in the statement are commented on and additional data of a general character submitted. Trade opinions or payments are given next. These are usually meager, very often confined to a mere general statement expressing the opinions of a limited number of local houses. A fire record concludes the contents of a typical report.

Advantages and Weaknesses.—Where the information has been recently collected, the mercantile agency report constitutes an invaluable source of credit information, particularly in regard to the historical development of the applicant's business. It is claimed, however, that the agencies' files are revised at infrequent intervals and in view of the fact that many foreign houses have within the past several years undergone numerous rapid changes, the reports fail to present an accurate picture of conditions as they exist at the time the information is sought. To be sure, the agencies will, on request, conduct an investigation

and render a more recent report. The time required to complete the investigation is so long, however, as to make the report useless when rendered, except for future references.

Credit Bureaus of Associations.—One of the bureaus in this group is the Foreign Credit Interchange Bureau operated by the National Association of Credit Men. This bureau is operated on the same principle on which all domestic bureaus of the Credit Interchange system of the National Association of Credit Men are based. It is a non-profit organization whose aim is to serve all of its members for a charge sufficient to cover the cost of operation. It is a clearing house through which all of its members who are interested in any foreign accounts may freely and unreservedly interchange the data contained in their ledgers, without the necessity of direct reference, each to the other, and without divulging the information under their own name.

Many commercial and industrial associations in different parts of the United States have established foreign departments or bureaus for the purpose of collecting and disseminating credit information concerning foreign buyers. Prominent among them are the National Association of Manufacturers and the American Manufacturers' Export Association. However, the most important bureau of the group is that maintained by the National Association of Credit Men.

Contents of Reports.—The reports rendered by the Foreign Credit Interchange Bureau contain columns showing length of time sold by each of the reporting subscribers; terms of sale; highest recent account; date of last dealings; the amount of present indebtedness, including outstanding drafts; amount past due; manner of payment; rating assigned by the subscriber, whether high, good, satisfactory, unsatisfactory, or undesirable; credit limited, if any; credit declined and reason for action; and remarks. In addition to this, the bureau also supplies a supplementary report containing information in regard to antecedents, distribution of purchases, general reputation of the concern, and the amount of insurance carried. From this report a credit manager may ascertain the extent to which the customer is buying in the American market, the classes of goods he is handling, and the character of business he is conducting, whether wholesaler, retailer, manufacturer, commission merchant, importer, exporter, agent, or forwarder.

One of the things which strongly recommends this source of

information is the recency of the data furnished. Moreover, the actual experience which different exporters have had in dealing with the subject of the inquiry is usually of far greater significance than the general information supplied by other sources in determining the extent and nature of the credit accommodation that should be extended. Another important feature is the cheapness of the service, necessarily, because the bureau is not conducted for profit. The membership fee of $75 and the charge for reports issued on request are intended merely to cover operating expenses.

The columns which are particularly significant in the interpretation of the credit interchange reports are those which reveal the amounts owed by the importer at the time of the investigation to all contributing subscribers; manner of payment; and terms under which other exporters are selling the applicant. If it is discovered that the prospective customer is accustomed to purchasing under a letter of credit, the credit manager would naturally feel more at ease in refusing a request for a 60 days' sight draft and in insisting upon terms to which he is accustomed. Again, if the "manner of payment" column indicates promptness on the part of the importer in accepting and paying the drafts or in paying his obligations represented by open accounts, the prospective customer is entitled to fair treatment and to liberal credit accommodations. The aggregate indebtedness to the reporting exporters finally shows whether or not a further extension of credit is advisable. In view of the fact that the field of the Interchange Bureau is limited to American exporters who are members, the value of the information relating to a customer's total indebtedness on merchandise purchased becomes extremely uncertain. In order to remedy the weakness and to enable inquiring subscribers to evaluate such information accurately, the supplementary report issued by the bureau usually contains percentages indicating the extent to which the subject buys in the United States and in other markets, foreign and domestic.

Credit Service Organizations.—One of the largest of the group is the National Credit Office. Although somewhat more comprehensive than the service given by either general mercantile agencies or credit bureaus maintained by associations, it does not intend to render complete data concerning all risks about which inquiries are made at any given time. No one

service has yet been devised which would justly be considered a complete and in every way satisfactory source of information. Nevertheless, the reports it renders are in many respects superior to those rendered by the other existing agencies, for they generally cover antecedents, financial condition, bank comment, trade opinions, and general remarks calling attention to the desirability or advisability of granting credit on the basis of the information submitted in the report.

One peculiar feature of this service is the continuity with which it is rendered to interested parties. Once a subscriber has displayed an interest in a foreign customer, he is thereafter kept informed of all important changes in the financial standing of the risk which may occur, without any other solicitation. Changes thus reported may be favorable, showing unusual progress, introduction of additional capital, and the life; or derogatory. If the former is true, it enables the credit manager to increase the credit limit and to stimulate more buying from his house. On the other hand, if the changes reported are unfavorable, timely efforts properly applied may result in considerable reductions in losses from bad debts.

In order to supply the continuous service and to render the reports referred to above, the organization employs a number of investigators with long experience, whose duty it is to cover the major trades in this country with a view to ascertaining the paying habits of foreign buyers, and maintains a large number of correspondents in foreign countries to conduct investigations in their respective territories.

Other services rendered by the institution take the form of bulletins furnished its clients periodically, containing information in regard to political and economic conditions in different foreign countries. It also advises on all phases of export technique, trade customs, and foreign commercial laws.

American Exporters.—Frequently, prospective customers give as references the names of other concerns in the United States with which they have had previous dealings. All such references should be investigated directly before shipment is made. It is important, however, to bear in mind the fact that concerns given as references are selected with a view of obtaining the most satisfactory recommendations. It follows, therefore, that only those exporters are referred to with whom the new customer has had favorable and business-like dealings. For this reason

it becomes necessary to widen the scope of the investigation beyond the exporters to whom specific reference is given. Other concerns may be then reached through the various organizations through which such information is commonly cleared, as shown in previous paragraphs, or by direct communication. Because of the duplication it involves, the latter method, except when used sparingly, is to be discouraged.

Banks as a Source of Credit Information.—Reliable information about foreign houses sending in orders for the first time may be secured with little delay from the larger American banks. Those banking houses which specialize in foreign trade are constantly revising their credit files and securing data on all buyers abroad. This information is obtained from the numerous branches which some of these banks established in foreign countries, and is supplied free of charge as a part of the regular service to customers. If the exporter's bank lacks the information sought, it is usually secured for him from another bank, since all banks have adopted the practice of freely exchanging credit information among themselves. Of the banking institutions performing this service, probably the National City Bank, Guaranty Trust Company, National Bank of Commerce of New York, and the First National Bank of Boston are the more prominent.

In numerous instances the information supplied by banks includes a complete financial statement of the new customer. Wherever statements of assets and liabilities are not furnished, at least an estimate of his worth is given, in addition, of course, to the experience other creditors have had with the risk. Banks are, as a rule, very conservative and guarded in their reports, which are too often incomplete. Whatever information they do give, however, is considered entirely reliable. It is oftentimes advisable to secure superior information verbally when a close acquaintance has been cultivated by the exporter with his bank's foreign department. In any event, the data secured from banks, even though deficient in many respects, serves to orient the credit manager with regard to the risk, for it indicates roughly whether the risk is good, bad, or indifferent, a knowledge of which is essential before undertaking any exhaustive investigation.

Publishing Companies.—Some foreign trade publications supply their advertisers with credit information free of charge.

Prominent among them are the *Philadelphia Commercial Museum* and *The American Exporter.* For a moderate fee, others than advertisers may secure similar advantages. The nature of the information furnished is very much like that supplied by banks and general mercantile agencies.

Sources Located Abroad

The most important of the sources located outside of the United States are traveling salesmen and the prospective customer himself. Some information may also be secured from various mercantile agencies situated in the locality of the buyer, but the data is for the most part said to be biased and unreliable. Inquiries may also be sent to banks in the city in which the applicant is located. Many foreign banks will reply, provided an international money order covering return postage and the small fee which is charged for the service is included. Other banks refuse to reply unless the inquiries are addressed to them through their American correspondents.

Several objections have been raised against the use of sources of information in foreign countries. Cabling is expensive, and too much time is consumed in the process of communicating by mail, so that when the report is finally received it may be useless, for the need for it as a basis for a credit decision might have long since passed. In the second place, it is difficult to determine the reliability of foreign agencies which sell credit information. Although many of them are entirely dependable, many others are unworthy. Then, too, lack of personal contact and close relations with the sources employed result in superficial, biased, and incomplete reports.

Traveling Salesmen and Agents.—Many American exporters have traveling salesmen abroad or employ resident agents. Although their chief interest is in securing orders, it is possible, nevertheless, to educate them by proper cooperation to the necessity of giving an unprejudiced opinion concerning the credit responsibility of their customers. Good salesmen generally appreciate the importance of carrying no bad accounts on their books and can be trusted, therefore, to give an unbiased statement of a customer's standing in the community and his management efficiency. They are on the ground, see the customer in his setting, and can learn many important details regarding his habits and the conduct of the enterprise. It should, therefore,

be insisted that they furnish at least one report about each customer at the time when it is of most value, namely, when an application for credit accommodations is made for the first time.

Direct Information.—Relatively little credit information can be obtained from the prospective customer himself. Financial statements are rarely furnished and in many countries they should not be asked for, lest the applicants take offense. This is particularly true of Latin and Oriental countries. Although in some countries the practice of submitting financial statements has already come into vogue, such places are few and far between. There is still a general aversion to divulging details regarding their businesses or personal affairs, probably because of the fear that strictly confidential information may fall into the hands of competitors. Another explanation for the general reluctance to supply financial statements is the method of taxation which prevails in some countries. Taxes are frequently based on the registered capital of the concern. Where this is true, companies usually register a nominal sum and intentionally refrain from keeping books of account. Because of this practice, it is frequently impossible to construct an accurate statement, and even if it were possible to do so, the fear that such statement might find its way into the hands of tax authorities serves as a deterrent. Finally, many foreigners are too sensitive and take offense at any action on the part of sellers which in any way reflects upon their personal qualities of honesty, ability, and integrity.

It should be observed that, even where financial statements are obtainable, they are useful only as a general guide and not as the sole reliance for a credit decision, partly because of inaccuracies, intentional or otherwise, and partly because of the difficulty in interpreting their contents. Methods of accounting that prevail in many foreign countries are loose and unsystematic. Hence many figures presented are often the result of mere guesswork, and since it is the natural desire of every customer to make as favorable a showing as possible, he may give himself all the benefit of the doubt in estimating the worth of his assets. Furthermore, credit managers, because of their unfamiliarity with values of real properties and other items appearing on the balance sheet in the country in which the customer resides, find it next to impossible to determine accu-

rately from the figures submitted the actual net worth of the business, as it is done in an analysis of statements in the domestic trade.

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PART III

CREDIT DEPARTMENT ORGANIZATION AND MANAGEMENT

CHAPTER XVIII

ORGANIZATION AND OPERATION OF A MERCANTILE CREDIT DEPARTMENT

Place of the Credit Department.—Probably because of its relative youth, much confusion is current in the minds of many people as to the proper place of the credit department in the business enterprise. Actual conditions only serve to accentuate this confusion, thereby making a solution more difficult. In very large establishments, one finds the credit department occupying a position similar to that enjoyed by the sales, purchasing, auditing, advertising, or any other major department. In these organizations it is not uncommon to have collection work carried on by a separate unit, usually, however, under the supervision of the credit manager. In medium-sized and small manufacturing and wholesale concerns the position of the credit department and the importance of its activities is colored by historical developments and existing personnel. Thus in many instances the president, vice-president, or head of the firm is possessed of the hobby of handling all financial aspects of his business, including credits and collections. This power is often delegated to the treasurer, in which case the bookkeeping or auditing and credit departments are merged under one department head. In other business enterprises credit work is closely supervised by the head of the sales department.

Because of the apparently chaotic position in which the credit department finds itself, as far as authority is concerned, many persons question the soundness of almost any position in which it may be placed. Some credit men feel, for example, that their authority should be subject only to the supervision of executive officers instead of being dominated by any head of another department. They possess and insist upon a spirit of equality and interdependence rather than an attitude of isolation and superiority; they do not, however, care to subject their decisions to the supervision of any department head of either coordinate or superior rank, save that of executive officers. Sales managers

and auditors, on the other hand, feel that the credit department, by the very nature of its functions, forms an integral part of their respective provinces, so that even when a decision is reached to the effect that the credit department be linked with some other unit, the question still remains as to what particular unit has a greater claim to its supervision. Shall it be merged with the sales department, or shall it become an integral part of the auditing or bookkeeping unit?

Arguments for Merging Credit and Sales Departments.—Two arguments are advanced in favor of placing credit work under the supervision of the sales department head. In the first place, it affords an opportunity of securing the greatest degree of cooperation of the sales force, both in gathering reliable data concerning customers, and in following up accounts and in making collections. Again, it is contended that, since both departments aim for the accomplishment of the same end, that of increasing sales, it is imperative that they act in unison and without friction, and that the only sure way of attaining the desired end is to subject these activities to the supervision of one department head.

Arguments for Merging Credit and Auditing Departments.—Advocates of the plan involving united effort on the part of the credit and auditing departments argue that both of these units are directly and vitally concerned with the financial aspects of their company, especially where the latter is controlled by the treasurer. It is the duty of the credit manager so to dispense credits as to keep his company's funds intact, to venture into the future and prophesy what conditions in collections will obtain several months hence, to provide the financial officer with the required data, as well as to speed up collections when business requirements call for additional cash. Both he and the treasurer are financial officers of their concern, for credit policy and sound practice have a profound effect upon the determination of a company's financial plan, and particularly on the amount of current financing that must be provided by the treasurer. Furthermore, both of these departments administratively belong together. The same records are used by both and much duplication could thereby be prevented.

Reasons for an Independent Credit Department.—Notwithstanding the truth of all of these arguments, it is believed, nevertheless, that all interested parties will be served

best through the establishment of a separate and distinct credit department, wherever the size of the business enterprise permits, on a basis coordinate with that of the sales or other major department and subject only to executive supervision and control. Several important reasons may be advanced in support of this view. To begin with, credit work is complex and intricate, requiring the full time of an experienced and properly trained executive. A credit manager is a specialist; the technique of credits and collections involves all the intricacies of the business world. It therefore requires a man of broad knowledge and experience. Because of the technical nature of this work, other department heads will frequently fail to appreciate the credit man's position and proceed to issue orders in ignorance of probable consequences.

A situation analogous to this is the tendency of department stores to separate buying from selling. Heretofore, almost without exception, the merchandise manager had complete supervision, except for hiring salespeople, over both buying and selling, while the various buyers also occupied the position of heads of one or more selling departments. Due to the fact that many of these buyers are seldom on the ground and that buying has become more difficult and complex because of the multiplication in brands, rapid changes in style, etc., thereby requiring all of the time of individuals especially trained in this phase of the work, there is a decided tendency in the larger retail establishments to relieve them of any direct selling responsibility and supervision over the sales force in the departments for which they generally buy and to establish two separate and distinct units for buying and selling, respectively.

A second argument in favor of this plan of organization is that it facilitates unbiased opinions and decisions, based upon actual evidence at hand, without fear of displeasing a superior officer under whose direct supervision the credit manager works. Furthermore, the sales and credit departments represent two different viewpoints. Salesmen are by nature optimistic and are likely to overestimate a debtor's ability to meet his obligations, whereas credit managers must of necessity remain conservative and grant credit with great care and caution if losses are to be kept at a minimum. As a result, clashes will often ensue, unless a credit manager's authority is clearly defined.

Finally, the plan of establishing a separate credit department

would substitute voluntary cooperation for cooperation through control. If anything, it will tend to develop an *esprit de corps.* For no one realizes the benefits of cooperation, the cornerstone of the present-day credit system, to so great an extent as the credit manager. He knows, as all other department heads should know, that the various departments must constantly work in closest harmony with one another. Should there exist the slightest friction between the sales and credit managers, for example, their company would be carrying an expensive load. A willing and competent credit manager cannot properly manage the credits for his concern if he is compelled to work with an incompetent and disgruntled sales manager, and *vice versa.* The fact remains that the ultimate object of both is to increase profits for their company. As soon as the credit manager assumes an antagonistic attitude toward the sales force or salesmen refuse to cooperate with the credit department, they are defeating the very purpose for which they are employed and developing a condition which militates against the interests of both and which inevitably proves detrimental to the entire organization. Hence, unity between them is essential; each must have full confidence in the other. The absolute necessity for teamwork, perfect harmony, and cooperation in its truest sense needs no argument. But it can be best accomplished not through dictatorship but through a volition born out of a complete and sympathetic understanding of the position of others, and, above all, the ultimate aim which all the departments are striving to attain.

Credit Department Organization.—Much of the success of any credit manager depends on the organization of his department and upon the system or lack of system with which the work is handled. If he is to occupy a position of a true executive, as he should, and have time for constructive thinking and careful judgment, he must not permit himself to become overburdened with a mass of detailed and routine work. Hence the importance of a system that will permit much of the detailed work to be handled efficiently by an assistant or clerks. Whatever the system employed, it must provide for accuracy of the records, efficiency in handling them, and accessibility so as to enable the credit department force to locate them with promptness and certainty.

Obviously, credit department systems vary in different concerns with the size of the house, number of accounts handled,

line of trade, and the degree to which this department is separate and distinct from other departments in the business enterprise. It is not intended, therefore, to submit a description of every conceivable system in existence. Rather an attempt is made to describe briefly a typical plan, which is subject to almost indefinite expansion, of handling orders, both from new and old customers and to indicate ways in which credit work may be efficiently controlled.

HANDLING ORDERS FROM NEW CUSTOMERS

When an order is received by the house, it is stamped with the date and hour of receipt, in order to remove any question as to when it was received. Another stamp may be applied bearing spaces for the approval of the sales or order and credit departments, respectively; also a space for the shipping order number. After an order has been received and thus stamped by the mail clerk, it is passed on to the sales or order department for approval and then submitted to the credit department. When it is received in the credit department it is, in most houses, stamped with a receiving stamp and sent to the agency desk or "credit editor" for checking.

Follow-up Credit File.—Should it be discovered that it is a first order from a new customer, a folder is prepared and an investigation of the applicant's credit and financial responsibility instituted. In the meantime the folder containing the order is placed in what may be termed a "follow-up credit file" several days ahead. This file is sort of a tickler which makes for accuracy and efficiency. It is almost indispensable where many new accounts are constantly being investigated and old accounts undergoing revision. This file merely consists of 31 divisions, one for each day of the month, each containing folders of accounts that are being investigated.

Scope of Investigation.—Obviously, the amount of the information needed before making shipment depends upon the line of business in which seller and buyer are engaged, whether the order is for immediate or future shipment, and whether it is small or large from the standpoint of the seller as well as the buyer, considering the customer's location and general condition of his business as set forth in the salesman's report. When an order is small and ratings are favorable and jibe with and substantiate the salesman's report, a first order may, under such

circumstances, be shipped on that basis alone, but additional data should be sought for as soon as possible in order to establish a credit limit. On the other hand, if the order is substantial or ratings indifferent or in conflict with the contents of the report submitted by the salesman, additional facts must be obtained before accepting the order. Just how much additional data are required would depend on the eagerness of the seller to roll up volume, the amount of apparent reliability of the facts made available by the several sources of information, and the extent to which they jibe or differ among themselves. Another point to be emphasized in this connection is that pertaining to the type of data most desired. In some instances it may be advisable to investigate thoroughly a customer's willingness to pay, or character; in other occasions financial data may be deemed most significant; while in still other cases general local conditions and ability to succeed may be stressed considerably. For this reason it may be advisable for a credit manager to classify the various sources of information according to the type of facts which they are best able to supply.

There follows a list of all possible sources of credit information that may be resorted to by credit managers in the process of securing adequate credit data. These sources are arranged in what is considered the order in which they are chronologically called into service. Thus, for example, salesmen's reports are listed first, because in many concerns salesmen are required to submit a report with every first order. Again, commercial agency ratings and commercial agency reports appear in the two following places, respectively, since most mercantile establishments subscribe to one or more of these agencies. Reference to previous chapters on "Sources of Information" will at once reveal a substantial duplication in the type of data which some of them ordinarily furnish. A credit manager should, therefore, exercise a nice judgment in the selection of those sources from which the most needed and reliable facts may be obtained at the least outlay. These sources of information are as follows:

1. Salesmen's reports
2. Commercial agency rating or reference books
3. Mercantile agency reports
4. Credit interchange reports
5. Special agency reports
6. Trade bureau reports

7. Financial statement secured directly from applicant
8. Direct inquiries to trade
9. Bankers' reports
10. Attorneys' report
11. Direct investigation
12. Court records
13. Corporation cards and services
14. Corporation manuals
15. Registers and directories
16. Trade and financial papers
17. Other customers in same line or location
18. Other sources of a miscellaneous character.

The Credit Card.—When an adequate amount of information has been collected, the folder and the reports that have accumulated in the meantime are removed from the follow-up credit file and referred to the credit manager for his decision. If the order is refused, the information should be organized in such shape that it may be presented to the sales department, if need be, in order to convince it of the wisdom of the credit manager's decision. Only by adopting an attitude which expresses willingness and readiness to show reasons for refusing an order will all possible friction between the two departments be eliminated and unquestioned confidence and cooperation gained. Thus, it is the practice of many houses first to pass all information obtained to the assistant credit manager to be written up according to some predetermined plan of procedure. Another reason for transcribing much of the data is that the information becomes so voluminous in a few years as to require too much space for filing and imposes an extra burden on the clerical force. Accordingly, it becomes necessary to boil it down in a compact and efficient way by summarizing only the important and relevant facts. A method which has found much favor in some concerns is that involving a classification of the data according to character, capacity, and capital.

If the order is approved, terms and a credit limit are assigned, a credit card is then made out, which is filed in a credit card cabinet in strict alphabetical order or alphabetically under the proper geographic unit, whereby the cards are coordinated with mercantile agency books, thus facilitating revision when new books are issued. This card contains a synopsis or summary of all

credit information from the various sources, including the name and address of the customer, type of organization, bank, terms, ratings of the two general mercantile agencies, summary of credit interchange reports, credit limit assigned, and remarks (see Fig. 33). As soon as the proper data are recorded on this card, the order is sent either to the order department, where shipping requisitions are issued, or forwarded direct to the latter.

The Credit Folder.—This folder contains all credit reports, on customers, which have been collected from agencies, bankers, attorneys, and bureaus; financial statements secured from the

NAME ____ IND. PART. CORP.

STREET ADDRESS ____ File No.

CITY ____ BUSINESS

BANK ____ TERMS

Year ____ Quarter ____ RATINGS

	1st	2nd	3d	4th	
BRAD. Dun					C. I. B.
BRAD. Dun					C. I. B.
BRAD. Dun					C. I. B.

CREDIT LIMIT

AMOUNT ____ TIME

REMARKS

FIG. 33.—Credit card used by manufacturing concerns and wholesale houses.

customer himself; and clippings from newspapers and trade publications which have a direct bearing on the name in question. These folders also contain copies of monthly statements forwarded to the customer as well as copies of all unpaid invoices. They probably constitute the single most important file in the credit department. Folders are usually filed alphabetically. In the smaller concerns no separate files are maintained for credit, collection, or adjustment correspondence. Under such circumstances all current correspondence is kept in the credit folder.

Card Index and Inactive Files.—Two other files are generally found in many credit departments. One is a card index containing the name and address of customers and their file numbers. The card index may be divided into two or more sections.

One of these sections merely consists of an alphabetical list of all accounts. Another contains a geographical list of all customers and serves as a cross-index for the alphabetical list and for all credit cards and folders if alphabetically arranged. A third section may contain an alphabetical list of accounts placed in hands of attorneys or agencies for collection or those which are in financial difficulties and need watching.

In the inactive file are placed all finished correspondence and other unnecessary and old material in order to prevent an undue accumulation of antiquated data in the credit folder. Similarly, when payment is received on an account, all paid items are checked on the proper statements which, together with paid invoices, are removed to the inactive file, which may sometimes be kept in the general offices.

HANDLING ORDERS FROM OLD CUSTOMERS

To handle expeditiously orders from old customers as soon as they are received by the credit department, they should be checked at least twice by the credit manager himself or by his assistant. No matter what kind of a checking system may be in use, it is advisable that the credit manager himself make it a point to examine all orders which represent fairly substantial amounts. In this way little irregularities which might not attract the attention of assistants may be caught by the trained eye of the credit manager.

In the first checking, all orders should be checked against the credit card as to name, address, credit limit established by the credit manager, and instructions under "remarks." In some houses celluloid cards or tabs of various colors accompany all credit cards, each color bearing a certain significance; thus, yellow may signal caution, red may indicate poor credit standing; clear, good credit standing, and so on. Orders easily cleared are let through quickly in this first checking and dispatched to the shipping department for immediate filling.

In the second checking special attention is given to the information in the credit folders. By means of a "Please Get" rubber stamp, clerks make the necessary folders available within a short space of time for the second checking. As a result of this process many more orders are either refused or accepted and sent on to the shipping department.

The remaining orders are probably retained on account of in-

adequate information of a recent character. They are, therefore, placed in the follow-up credit file and an investigation instituted as if they were orders from new customers. To be sure, in a majority of cases the revision investigation will be far from exhaustive, consisting, in all probability, of a request for a recent mercantile agency report, or Credit Interchange Bureau clearance. As the new information is collected, proper notation is made on the credit card and the various reports filed in the credit folder. From this point on, both orders from new and old accounts are handled in a similar manner.

MEASURING RESULTS

Much has been written in a general way of the value of certain credit policies, but little discussion is to be found concerning the means by which actual progress made under these policies may be definitely ascertained. Yet every credit manager appreciates the value of reviewing and analyzing the results of his department's efforts in order that intelligent comparisons may be made in the various operations of his department. These comparisons may be made on a daily or monthly basis. In any event it is essential that the results of the credit and collection policies be tabulated and recapitulated at the end of the year for his own use and for presentation to the executives in the form of a report summarizing the department's activities and their effect.

To be sure, different kinds of business require different sets of facts. Nevertheless, the facts suggested here may prove useful in almost all lines.

Periodic Lists of Overdue Accounts.—Many houses have adopted a practice of compiling lists periodically, usually monthly or quarterly, giving the names of customers whose accounts are overdue, the amount involved, and the extent to which they are past due. Such lists may provide spaces in which to list the various amounts becoming due each month over a period of six months or a year, and the total past-due indebtedness at the end of such period. A comparison with previous as well as subsequent lists indicates roughly the results obtained by the credit department. It does not, however, reveal the whole truth, for it must be borne in mind that progress of a credit department cannot be measured accurately by the extent of overdue accounts and losses from bad debts alone.

Figures Needed.—To overcome this objection it is suggested that the following figures be compiled on a monthly basis as follows:

Year	Total outstandings	Total past due	Per cent past due	Total number of accounts	Number of accounts past due	Per cent of accounts past due	Collections during month	Per cent of collections to outstandings	Average collection period or turnover, in days
Jan.									
Feb.									
Mar.									
Apr.									
May									
June									
July									
Aug.									
Sept.									
Oct.									
Nov.									
Dec.									
Totals for Year									

Once these figures are thus tabulated, they may be reduced to graphic charts and show at a glance the general trend in collections. A comparison of these figures with those of other months of the same year and with similar months of previous years will indicate the extent of progress of retrogression in collecting accounts so that corrective measures may be adopted wherever possible. It may also be possible in the future to make similar comparisons with the average of competing houses in the same locality with a view to determine whether any given concern is above or below that average.

By dividing the total past-due amount into the total outstandings the per cent of past-due indebtedness is arrived at, which can be used as a barometer indicating whether the general trend

is downward or upward. It is of utmost importance in this connection to make allowance for differences in amount of sales. For example, the percentage of past-due accounts may be 16 on the first of December, and 12 on the first of January, although the amount of past-due indebtedness in dollars and cents remains the same. This is so because the preholiday sales during the month of December effected a considerable increase in the sales figure over the previous month on which this percentage is based. As soon as some of the accounts receivable are liquidated, the tendency is for the percentage of overdue accounts to increase, unless a material improvement is at the same time effected in collections.

The purpose of the columns recording the number of accounts overdue at any given time is to show whether the average amount of these poor accounts is increasing or decreasing. When studied over a period of time, it may be possible to arrive at interesting conclusions concerning the desirability of accepting accounts of a certain size and the circumstances that should govern such practice.

The percentage of collections to outstandings is determined by dividing the total amounts collected during the month by the total accounts and notes receivable outstanding at the beginning of that month. When plotted on a chart, the resulting curve indicates the general trend in collections, the result of which, if unfavorable, may be to cause an inauguration of improvements in handling accounts and to stimulate inquiry into external causes that may be responsible for such changes. By extending such a study over a period of time, a credit manager will be able the more closely to estimate his collections in the future, an item of considerable import to concerns operating on a budget plan. Thus, if experience has shown that collections amount to 80 per cent in June and 75 per cent in July, figures might be drawn off in the following fashion:

June 1, Receivables	$100,000
Estimated Collections for June	80,000
Overdue June Receivables	$ 20,000
Estimated Sales for July (furnished by Sales Department)	75,000
July 1, Receivables	$ 95,000
Estimated Collections for July	71,250
Overdue July Receivables	$ 23,750

To determine the average collection period or turnover, in days, it is necessary to take into consideration the regular terms of sale and the percentage of accounts receivables, as of the first of the month, that has been collected during that month. If the usual terms of the house are 30 days, all receivables outstanding at the beginning of the month must be collected during the month if collections are to equal 100 per cent. If only 50 per cent of the receivables have been collected, the turnover equals twice the length of the usual terms, or 60 days. Similarly, on a 25 per cent basis, the average collection period would be four times the normal, or four times 30 days.

Other figures that a credit manager may use advantageously with a view to measuring the efficiency of his efforts are as follows:

1. Relationship of accounts and notes receivable to sales. Are the receivables increasing or decreasing in the proper proportion to sales?
2. Percentage, by months, of total number and amounts of remittances received with discount taken.
3. Percentage of total number and amount of accounts paid net at maturity.
4. Number and amount of orders received during the month as compared with previous months and with same month a year ago; number and amount of orders rejected during the month.
5. Number of new accounts opened during the month as compared with other periods.
6. Finally, there should be a chart at the end of the year showing the number of accounts and amounts charged to suspense; the amount recovered; net loss or amount charged to profit and loss as uncollectible; the percentage of bad debts to sales; and the balance in suspense.

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CHAPTER XIX

ORGANIZATION AND OPERATION OF A BANK CREDIT DEPARTMENT

It should be emphasized at the outset that the type of organization of a bank credit department must necessarily vary with the size and character of the institution and the nature of the community it serves. There are banks in which two or three officers together with a discount committee perform all the necessary functions. On the other extreme, there are to be found some of the largest banking houses with as many as a hundred officers and in which the work is highly departmentized. In such institutions the credit department is in charge of a credit manager, who may rank as vice-president or assistant cashier. Between these two extremes there are a large number of medium-sized banks located in growing communities where the executive officers sooner or later reach a point where they find it impossible to maintain a personal and immediate contact with all customers whose names are carried on the books.

In order to overcome these difficulties and to assist them to keep in touch with borrowing customers, such banks generally conclude that the installation of a credit department, which will gather and file all valuable information and make it readily available as occasions arise, will solve their problems. Thus, it is not unlikely that the number of credit departments in banking institutions will be greatly increased as the communities whose needs they serve grow and develop and as progress is made in the size and number of accounts handled. The *raison d'être* of every bank credit department is invariably found in the need of the loaning officers for assistance in assembling and interpreting facts and opinions that will help them to determine intelligently whether or no credit should be extended, and in what amounts.

It is not intended to make the exposition of the organization and operation of a bank credit department so broad as to cover all sorts of banks. An attempt is made rather to explain the

operations of medium-sized and very large credit departments, for it is believed that a comprehension of these two typical organizations will enable every resourceful student of the subject so to modify the mechanical devices and forms to be described as to conform with the needs of the particular bank under advisement.

Control of Bank Loans.—The ultimate source of control is vested in the board of directors. They are required to supervise the work of all their officers, particularly with respect to loans. In some banks they meet once a month or every week, while in others they meet every day. Only important matters are referred to them at their periodic meetings. If the majority of the directors disapprove of the loan under advisement, that decision is final, the opinion of the president and of other officers to the contrary notwithstanding. Since in the majority of banks all the directors do not meet every day, however, it is customary to delegate the loan-making power to a loan and discount committee. This committee is usually composed of three or more members, including the president and two or more other members of the board of directors, among whom are generally included the first and second vice-presidents and cashier. To them all applications for loans exceeding certain stipulated amounts must be submitted at their daily meetings. This committee usually makes a complete report of all applications handled each week or month, as the case may be, and the decisions rendered to the directors under whose supervision it operates.

Next to the loan and discount committee, the president exercises the greatest amount of control over bank credits. All important loans are referred to him by the credit manager for approval or disapproval. Ordinarily, the president does not go into the matter in great detail and acts largely on the recommendations of the junior officers, who analyze the situation with great care. Then follow the vice-presidents, one or more of whom may be placed in charge of certain classes of accounts and who pass upon most credit matters. Where the number of accounts handled is large and the lines of business served are numerous, assistant vice-presidents and assistant cashiers may be engaged in credit work. These officers interview customers and review the financial condition of borrowers with a view to establishing lines of credit, the same as their senior officers,

except that they are likely to handle smaller and, consequently, less important accounts. Finally, the credit manager may have authority to make small loans on good security or those which are otherwise reasonably safe.

CREDIT DEPARTMENTS OF MEDIUM-SIZED BANKS

Organization.—In every bank of sufficient magnitude to warrant the required outlay, the personnel of the credit department ordinarily includes an assistant to the credit manager and one or more stenographers. It is advantageous to have, in addition, one trained investigator. In nearly all but the very large banks the credit and collection work is handled by one department. Hence, the work naturally divides itself into the major functions of credit investigation and decision, recording, filing, correspondence, and following up accounts.

Functions of the Credit Manager.—The credit manager, of course, exercises general supervision of the entire operation of his department. Each day he looks over the new account cards, which are made out simultaneously with the signature card. These cards are sent to the credit department by the clerk at the new account desk. From them, information may be secured concerning accounts opened by new customers, character of accounts, size of deposits, special agreements, if any, and references and affiliations. Upon examining these new account cards he will determine whether or not folders should be made out and investigations instituted concerning those names.

The next function is to interview customers and prospects with a view to securing information sought by the loaning officers as a basis for their decisions. During these interviews he should not only gather information for credit purposes, but must also in every way attempt to cement the friendship between borrowers and the bank, by ascertaining their grievances and complaints, and proceed to smooth them over and remove the causes wherever possible.

Another function is to act as intermediary between the loan and discount committee and his department. From this committee he learns all facts and conditions underlying the granting or refusing of a loan and the position of each individual member when a vote is taken. To obtain these facts, he usually acts in the capacity of secretary, attends all the meetings, and keeps minutes of the proceedings. This enables him to keep in

touch with the policies and wishes of his executive officers and adequately to protect the bank against possible losses.

He then proceeds to dictate replies to credit inquiries from correspondent and other banks and all commercial houses.

Still another function of the credit manager is to go over carefully all financial statements received during the day and indicate by means of marks those portions which are to be transcribed to the comparison of statements form. He then reads all correspondence concerning loans and new accounts, marking those sections which are to be incorporated in the respective credit folders. Finally, it is his duty to review and inspect all new and revised folders prepared during the day by his assistant.

Functions of the Assistant Credit Manager.—The general function of the assistant is to keep the department running smoothly and efficiently and to solve problems of minor importance, involving matters of routine, as they arise. It is his duty to distribute the work to the other employees of the department and to assume full responsibility for the successful completion of the work assigned. He checks over the new account cards and sets the machinery in operation for assembling adequate information on names that apparently justify the development of a folder. All commercial accounts whose initial deposits are substantial are ordinarily marked for investigation. Requests are thereupon forwarded to mercantile agencies for reports and letters sent to bank and trade references requesting information on the subject under consideration. If the bank is a member of a Credit Interchange Bureau, an inquiry ticket is sent to that organization. In the majority of cases, a form letter is sent simultaneously to the new account acknowledging appreciation of his business and requesting him to fill out an enclosed financial statement blank and return it in the stamped enclosed envelope. It is usually explained in the letter that it is to the borrower's advantage to furnish the bank with a statement of his financial responsibility, so that the bank's replies to legitimate inquiries regarding his credit standing may be made advisedly and intelligently. In this connection it should be mentioned that where a credit manager's assistant is employed, he not only makes all initial inquiries, but he also handles in a similar manner all inquiries concerning accounts undergoing revision.

As soon as the replies to inquiries are received, the assistant marks all portions which are to be transcribed and passes them on to a stenographer. He then proceeds to copy to the "comparison of statements" form all statements marked by the credit manager. Finally, he consolidates into the credit folder file all data secured from other departments of the institution.

CREDIT DEPARTMENTS OF LARGE BANKS

Organization.—A large credit department, such as found in many banks of the larger cities, includes among its personnel a credit manager, an assistant, two or more division heads, one or more investigators, clerks, and stenographers. In addition to the several divisions already implied by the enumeration of the personnel, a large department naturally divides itself into several sections dealing with investigating, filing, statement analysis, and stenographic work, respectively.

Functions of the Credit Manager.—Not unlike the manager of a medium-sized department, the manager of a large department exercises supervisory power over the investigating, filing, analysis, and stenographic sections of his department. He organizes the work in a manner which makes for efficiency and employs the proper type of assistants. He cooperates with credit departments of other institutions with a view to securing reliable trade information and to obtaining the best results in the handling of inferior or bad accounts. He passes upon the numerous credit letters sent daily to the bank's many clients and correspondents. Finally, it is his function to keep in touch with the bank's borrowing customers and to acquire the broad knowledge concerning them requisite to proper and expeditious handling of his work.

Functions of the Assistant Credit Manager.—The chief duty of the assistant is to keep in close touch with the entire operation of the department and to assume responsibility for the efficiency of the various divisions and sections into which the work is separated. He is in a sense a "general utility man" and constitutes an important adjunct of the department. He is the understudy of the credit manager; hence it is important in the selection of a man for this position that an individual of sufficiently high caliber be secured so that he will be able, in case of emergency, to fill the manager's position in a creditable manner.

Functions of a Division Head.—Men occupying the positions of division heads ordinarily come from the ranks of investigators, for investigating training and experience are well-nigh indispensable prerequisites. Where no separate statement analysis section is maintained, it is their function to handle this work themselves. They assign work to the investigators, supervise and inspect all investigations, answer all inquiries or requests for credit information, and analyze credit risks for the loaning officers of the institution.

In separating the work into divisions three different methods may be found in use. In some banks the work of compiling information for clients and revising and investigating their own accounts is divided on an alphabetical basis. In other banks the distribution of responsibility of credit work is handled on a territorial basis. These territories or districts may cover one or more states or Federal Reserve Districts. It is quite evident that several pronounced advantages are to be gained from this form of divisional responsibility. Working constantly in a given territory, a person becomes thoroughly acquainted with all the accounts located therein. He is in a position to acquire an intimate knowledge of the prevailing conditions in any one locality and to know, consequently, how best to serve the needs of borrowing accounts. Local publications can be followed up, and through this specific knowledge of the general conditions prevailing in a particular portion of the country a person is able to size up a credit risk and know his idiosyncrasies far better than when little is known concerning local conditions.

A third plan is to distribute responsibility for credit work according to lines of business. It is argued that anyone following current events knows the differences in conditions existing in different parts of the country, whereas few possess the specialized knowledge of a technical nature requisite to an intelligent analysis of credit risks in a particular industry. Only persons trained along these lines are fitted to analyze data peculiar to a given line of trade, to discuss matters relative thereto, and to pass intelligently on credits. Accordingly, in banks catering to certain special industries there is a tendency to divide the credit work according to lines of trade; this makes possible the acquisition of a highly specialized knowledge, thereby resulting in mutual helpfulness and a better understanding between debtor and creditor.

Functions of Investigators. –The duties and qualifications of a credit investigator have already been treated at some length in an earlier chapter. He is a sort of commercial detective. His function is to obtain all information available regarding concerns under investigation as quickly as possible. Otherwise he will delay and hinder the operation of his department. He should have a full measure of resourcefulness and initiative and never be content to follow mechanically the customary channels in securing credit data.

Functions of Filing Clerks.—These clerks occupy positions which require care, efficiency, and intelligence in filing papers with promptness and in such manner as to make them readily available, when needed. The exact duties of these clerks vary with different banks. Some of the duties with which they are generally charged include, in addition to that of properly filing the mass of data collected, the opening of the daily mail, making up new credit folders, ordering and keeping record of commercial agency and Credit Interchange Bureau reports, clipping newspaper and magazine articles, and other miscellaneous duties as may be required from time to time.

Securing Information from Other Departments.—Outside of the credit department itself, there are several sources within the bank from which information must be secured in order to aid it in its efficient operation. These are as follows:

1. The new account desk
2. The loan and discount committee
3. The correspondence files
4. The loan and discount department
5. The analysis department.

As previously mentioned, the new account clerk sends in at the end of each day, to the credit department, a card for each account opened during that day. It gives the name, address, occupation or title of the client, character of the account opened, references and affiliations, and the amount of initial deposit.

Acting in the capacity of secretary for the loan and discount committee in many instances, the credit manager acquires knowledge concerning the reasons for specific action taken by the various members of the committee, individually and collectively.

All finished correspondence dealing with the establishment

of an account or with the extension of credit accommodations should be made available daily to the credit department in case such files are kept in the general offices. From these files the credit department ascertains who the borrowers are, negotiations developed, and specific agreements and provisos relative to the establishment of any one account.

The loan and discount department, to cooperate effectively, must furnish the credit department with information regarding loans actually made and advise some time in advance of approaching maturities. Lists of names involved should be furnished daily, containing the amount of the note, whether secured or unsecured, the total indebtedness, the rate of discount, and remarks.

The information to be obtained from the analysis department deals with the average net and ledger balances, the proportion of these balances to credit extensions, and the profitability of the account since it became active. In some banks the records of this department are sent monthly to the credit department from which are copied the facts stated on a card provided for the purpose.

CREDIT DEPARTMENT SYSTEMS

Many systems and mechanical appliances have been devised and new ideas are being evolved constantly by manufacturers of indexes, card systems, and cabinets. In choosing one of these systems, each credit manager should bear in mind the results to be attained rather than the mere means. The files should be so arranged as to permit the greatest accessibility and quickness and accuracy in filing. If the necessary data cannot be secured from the files when needed, much valuable time is lost, and if such delays occur frequently, all operations may soon come to a standstill. Cabinets should be fireproof so as to safeguard the invaluable mass of information, compiled during a long series of years at the expense of considerable labor and money, against fire contingencies. The filing system is the backbone of a bank credit department and no real credit department is possible without it.

The Credit Folder.—Although there is considerable lack of uniformity among bank credit departments in regard to their filing systems, because of differences in requirements and comparative age of the institutions, each bank credit department

nevertheless uses some sort of a system for filing credit information folders. The folders themselves are of the letter-sized expansion pressboard type or of the lighter manila style. The former are used for the more important and active accounts on which much information is likely tc be collected, while the latter are reserved for accounts of a less popular character, concerning which comparatively few data are to be assembled.

In the event credit information concerning a given name becomes bulky and voluminous, it is necessary that it be so classified and arranged in the folder as to make it instantly available. In anticipation of this possibility, many institutions have adopted a folder arranged on the order of a book, containing several divisions separated by index sheets. No less than five divisions or sections are ordinarily made. The first division contains the "comparison of statements" sheet and all financial statements concerning the risk, arranged in chronological order. On the "comparison of statements" form are transcribed all statements obtained from various sources. In the second division of the folder are placed sheets covering the results of interviews and investigations. These include interviews with banks, brokers, and trade houses, as well as direct interviews with the partners or officers of the borrowing concern. If the name under consideration is that of a commercial paper borrower whose notes have been purchased in the open market through a brokerage house, a memorandum sheet covering the date of purchase, amount involved, due date, rate, and name of the broker is appended to the sheets relating to results of interviews and investigations. In this section is also included a printed form which is usually filled out by the new account clerk in case the borrower carries an account at the bank. This is known as the "opening sheet" and is sometimes placed in front of the folder. This form covers all details pertaining to the opening of an account, is filled out simultaneously with the signature card, and contains the name, residence, and business address, date the account was opened, character of the account, by whom introduced, references and affiliations, and size of the initial deposit.

The third section contains agency reports as well as reports from Credit Interchange Bureaus. In the fourth section are placed all correspondence with banks, brokers and trade houses concerning the account in question, including carbon copies of letters

sent to these sources of information, as well as copies of letters written by the credit department in reply to inquiries regarding the subject. This item is frequently, however, placed in the next and last section covering miscellaneous items, such as newspaper and magazine clippings and an inquiry sheet showing the names of banks which have made inquiries concerning the account.

Some credit departments prefer to classify all information contained in the credit folder into no more than two divisions, on the basis of whether the information has been secured from direct or indirect sources. All direct data is then clipped on one side of the folder and indirect information on the other side. The various items making up the folder, instead of being arranged in book form, may be fastened at the top and arranged chronologically in each division.

If the name under consideration carries an account at the bank, the direct information division begins with the "opening sheet" referred to in a previous paragraph. Following this is the borrowing sheet, showing the date, amounts borrowed, due date, rate, and remarks. If the account is a commercial paper name as well, the borrowing sheet is followed by a memorandum showing date and amounts purchased, as well as the current borrowings of the account and the high and low points. A sheet showing total borrowings through all banks and brokers is inserted next. Following is the "comparison of statements" sheet and the respective financial statements, received from the several sources. Finally, all interviews with brokers, officers, or partners of the borrowing concern as well as all correspondence of a direct nature are clipped on the direct information side.

The other or indirect information division contains a general information sheet showing the business in which the subject is engaged, the names of other banks which have dealings with the account, and the names of trade references, note brokers, and other interested parties. Then follows a memorandum of inquiries. Following this are newspaper and magazine clippings, sheets covering the results of interviews with banks and trade references, and reports of mercantile agencies and Credit Interchange Bureaus.

Advantages of Transcription.—It is frequently advantageous to mark up for transcription all agency reports, financial statements, and letters received in response to requests previ-

ously made. Although considerable stenographic work is involved in the process, it has been found advantageous, nevertheless, to transcribe the substance of reports and letters received, noting, of course, the date and source of the information. In the first place the information is copied in chronological order that is not easily disarranged. A more important consideration is that pertaining to the bulkiness of material in the folder. By transcribing the mere substance, a great many separate letters and reports, headings, formal conclusions, and other irrelevant matter are at once eliminated and considerable space is thereby made available for more pertinent material. Probably the most important advantage, however, is that the information may thus be classified under proper headings, such as financial responsibility, business ability, and character. These are always kept in the same order so that, if a study of a particular quality is to be made, the credit manager or any of the loaning officers knows exactly where the information bearing on that quality is to be found. Furthermore, all important elements bearing on a given quality are concentrated, thereby obviating the possibility of overlooking pertinent matters scattered throughout the folder.

Filing Credit Information.—There are differences of opinion regarding the best methods of filing. Some credit managers prefer to file all information in strict alphabetical order; others prefer a geographic division of the files, with alphabetical subdivisions by names of accounts under each geographic unit; still others find it advantageous to divide the files in accordance with the types of names handled. While it is difficult to describe all systems of filing in use at the present time, an attempt will be made nevertheless to indicate some possibilities for arrangement of files on the basis of logic and convenience. It will thus be seen that a filing system must be fitted to the bank and no attempt should, therefore, be made to adapt the bank to the system. For example, in some banks, files and folders covering bank accounts are not regarded as belonging to the credit department; accordingly, they are kept in another department. In other banks, these names are handled together with commercial accounts.

Two separate divisions may be had for deposit and loan accounts and for commercial paper names. In both of these divisions folders are usually arranged alphabetically. Where

these two classes of names are filed together, it is advisable to distinguish them by means of colored index tabs placed on the folder. Similarly, one or more files may be had for bank names, one for correspondents, one for bank non-accounts, etc. These folders are ordinarily filed geographically. Where more than one class of bank names is included in one file, distinction should be made by the use of colored celluloid tabs.

Information on commercial non-accounts and on miscellaneous names arising from inquiries is frequently kept in a separate file division. These folders are filed alphabetically and may also be classified and distinguished by colored index tabs. Bank non-accounts may be kept separately or filed together with commercial non-accounts and the miscellaneous file. If kept separately, they are filed on a geographical basis.

The Index Card File.—Every credit department should have an index credit card for every account, giving the name and address of the account and the folder and file numbers or other symbols by which they are designated. Index cards are always filed alphabetically, and are indispensable when files are divided into several separate sections or when folders are filed geographically. Through the index card file one can immediately learn in what division a given folder is located. Another advantage derived is that the index file acts as a check on the folder files, thereby preventing losses through misplacements and inaccurate filing. Folders are sometimes removed by one of the loaning officers without knowledge of the filing clerk. Reference to the index will at once reveal the fact that a folder has been made out for the account in question but that it has either been misfiled or deliberately removed by one of the bank officers or employees. Further to obviate such annoyance arising from inability to locate folders rapidly, some banks require that a person removing a folder from the files place a slip bearing his name in place of the folder. When strictly adhered to, good results may be obtained from this method. An official, when careless or in great haste, however, may take the privilege of not conforming strictly to the rule, thereby giving rise to the difficulty just described. A third advantage closely connected with the one preceding is that the index file furnishes definite knowledge whether or not there is a folder on the name under consideration.

Some banks have, in addition to an alphabetical index, a trade

index. Such an index facilitates the work if a revision of all names in a given line of business is necessitated by certain conditions. Index cards filed by lines of business or industry also lend themselves to uses for solicitation purposes, an item of considerable importance to some institutions.

The Pending File.—Many matters come up in the daily routine of the department which cannot be settled for some time. The installation of a pending or tickler file obviates the possibility of delaying or forgetting important matters. Such a file may be divided into 12 monthly divisions with 30 or 31 subdivisions under each. A simpler plan is merely to have 31 divisions, one for each day of the month. Papers filed under each daily division are to be arranged alphabetically. For example, a folder of a new customer would be placed in one of the divisions under the date when the receipt of information is expected and the matter is to come up again. Unless matters are postponed more than 30 days, it is quite evident that one monthly division containing 31 subdivisions would suffice.

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CHAPTER XX

RETAIL CREDIT DEPARTMENT ORGANIZATION AND MANAGEMENT

For our purposes we shall describe the organization and operation of a large credit department such as may be found in many of the department stores in the larger cities. To be sure, such an organization will prove too elaborate and expensive for the smaller retail establishments, but may be reduced proportionally and several of the more specialized duties handled by one person. Several systems or methods of handling specific credit problems will be described, so that any retail institution may find it possible to employ one of them in some modified form.

OPENING AN ACCOUNT

Methods of Securing Accounts.—Whereas by far the largest proportion of charge business of any established retail store comes from old accounts, considerable thought and attention is given by every progressive merchant to securing new and additional charge patrons. One of the methods of obtaining new accounts is through direct application from the prospective customer. Another profitable method is to carry out periodically intensive campaigns of solicitations directed to persons listed in mercantile agency rating books as satisfactory risks. A third method is to develop charge accounts from customers who have previously purchased large amounts on a C.O.D. basis or who have given personal checks of substantial amounts in payment for purchases. Both of these indicate a fair degree of financial responsibility. When sufficient attention is given to such transactions, many desirable accounts will be added to the list already on the books.

Application for Credit.—In small establishments, where the credit manager can interview personally all prospective patrons, it is a comparatively simple matter in many instances to reach a decision solely on the basis of such interview. With an increase

in size of the store, however, it becomes necessary to delegate this power to one or more "application clerks." Under such circumstances, it is quite important that the clerk receiving the application note in an appropriate place on the form his judgment as to the apparent credit responsibility of the applicant.

There appears to be considerable difference of opinion as to whether the position of application clerks, or even credit managers, should be filled by men or women. Some merchants believe that a woman is more capable than a man of meeting a woman customer on a common ground and of securing essential data. On the other hand, many stores feel that women customers normally prefer to deal with a man, because, it is argued, a man is usually more courteous and attentive to customers than a woman. Irrespective of whether a man or a woman is charged with the duty of securing applications and interviewing prospective patrons, it is essential that that person be competent and give every appearance of being familiar with human nature and the policies of the house regarding matters of handling applicants.

Because of the impression of a third degree conveyed by the method of questioning the applicant in detail, many retail establishments adopted a plan of having the prospective customer fill out an application form provided for the purpose. In cities where a credit bureau is in operation, the member stores are supplied with a uniform application blank to be used when requests for credit accommodations are made from them. In many cities these blanks are filled out in duplicate, in order to supply a copy to the credit bureaus. These forms usually contain spaces for the following information: name in full; residence; former address; bank; property claimed, in whose name, and value, whether encumbered or free; references; remarks or personal impression; and signature.

1. Name in Full.—The first name as well as the last must be given in full. Otherwise confusion between names having similar initials is likely to result, particularly in large establishments handling many thousands of accounts. It not only causes embarrassment when names are confused, but sometimes losses are quite likely to be incurred as a result. Furthermore, the full name will indicate whether the account is opened in the name of the husband, wife, etc. If in the name of the husband, it becomes the duty of the store to ascertain the extent of his

responsibility in the account, for a husband is in some states not responsible for debts incurred by his wife individually, irrespective of whether or not she has used the prefix "Mrs." Under such circumstances, it is advisable that notice be served on the husband to the effect that an account has been opened in his name. This will give him an opportunity to confirm or decline the arrangement.

2. Residence and Former Address.—The part of the city in which the applicant resides gives an idea as to the applicant's means and responsibility and whether excessive rents are paid, in case the property is not owned by the would-be charge customer. The former address, together with the present address, facilitates complete identification by references later consulted and by the credit reporting bureaus. If it is revealed that the applicant is a newcomer, it is essential to determine whether he is a temporary visitor, and, if so, to obtain the full home address in addition to the temporary address.

3. Business or Occupation.—The name of the concern with which he is connected or of which he is a member or officer should be obtained; also the length of time engaged in the capacity should be stated. Some stores also require information concerning the salary or wages received by the applicant. To obtain this bit of information much diplomacy must be exercised by the credit manager, since many persons resent disclosing such intimate facts,

4. Business Address.—In the event the applicant should later change residences, it will be a simple matter to locate him, if his exact business address is known. Such knowledge is also required for the purpose of making an investigation, verifying the applicant's statements and tracing him, if he later moves to another town or city.

5. Bank.—Possession of a deposit account by a customer usually indicates thrift and a desire to establish a credit balance. Knowledge of the bank with which the customer deals helps to verify some of the facts stated in the interview and sometimes affords valuable information. The quality and extent of information which may be gained through that source depends, of course, upon the bank's willingness to cooperate in the exchange of credit experience.

6. Property Owned and Encumbrances Thereon.—This information can be readily verified through an attorney or a credit

bureau, and if the value of his equity is substantial, greater reliance can be placed on the customer's ability to meet his obligations ultimately.

7. References.—Three references are usually required, preferably those of other merchants from whom purchases are or have been made on charge accounts. Next in preference are names of individuals already on the books of the store, for from these references a customer's movements may be readily traced in case of his disappearance. Personal references are frequently the only ones offered by an applicant. Because of the inclination to refer only to persons who are favorably disposed to the credit seeker, their value is limited to that of securing corroborative information and in assisting to locate the risk in the event of a change in residence.

A highly desirable reference is that of the employer or some responsible officer of the house by which employed. Such a reference is sometimes difficult to secure, however, on account of the unwillingness and general resentment on the part of prospective patrons, who are frequently possessed of peculiar business ideas.

8. Remarks.—As already indicated elsewhere, the credit manager of large establishments finds it impossible to interview personally all applicants. A clue given by the application clerk based upon his first impression of the intending customer is, therefore, of tremendous importance in some cases in determining what decisions should be rendered. These remarks are usually brief and impressions are often expressed as "OK," "Unreasonable," "Bears watching," and the like.

9. Signature.—An applicant's signature is a particularly important factor in stores where it is used for identification purposes when making purchases. As will be shown in a later portion of the present chapter, some stores employ a coin or card system as a means of identifying *bona fide* charge purchasers. Under these circumstances, a customer's signature on the application blank may be well dispensed with; otherwise it is essential that it be secured as a protection of the interest of the store and of the customer as well.

Handling the Application.—The methods of handling applications and the time elapsing between receipt of an application and opening of the account vary considerably with the size of the store, type of risk, and facilities at hand. If the store is

relatively small and the risk favorable, the account can be rated immediately. The time required in opening such accounts is limited to that of preparing the necessary forms and recording the name in the proper place. Again, where retail credit bureaus are available, it is possible to secure the desired information and arrive at a decision within a comparatively short period of time, particularly when direct telephonic lines connect the member store with the bureau.

When the store is large, facilities of securing information inadequate, or when an exhaustive investigation is necessitated, it is customary to place the various applications in a temporary container or to file them in pigeonholes arranged alphabetically. Periodically, say two or three times a week, the new account clerk collects all the applications thus filed, references are cleared, additional sources of information resorted to, the information is attached to the respective application folders, and they are submitted to the credit manager for a decision and rating.

Assigning a Limit.—Every account at the time it is opened should have a definite limit placed upon it beyond which it is considered unwise to approve purchases on charge accounts. Limits also serve as a guide to authorize in checking purchases at the refer desk or in the delivery department, as the case may be. Again, limits, when properly watched, afford a quick and effective warning of approaching danger in an account's activity, thereby reducing losses from bad debts to a minimum. The assignment of reasonable limits is of equal service to the average customer. It serves as a check against reckless buying and general extravagance.

Several methods of determining limits are to be found in practice. A customer may be asked what limit he himself wishes to place. In other instances, a limit is determined by the credit manager on the basis of information obtained regarding his paying capacity and habits. In some houses the amounts assigned are governed largely by the method of checking or authorizing, depending upon whether the system is centralized or decentralized. Thus, one prominent concern places its limits in six groups from $25 to $200 depending upon whether the risks have limited buying power, are fair, need watching, are good, well-to-do, or wealthy. Another house classifies its accounts for rating purposes as follows: employees' accounts; temporary and "accommodation" customers; $25, $50, $100, and $500 accounts; and

those which have an unlimited paying capacity. Limits as well as ratings are usually designated by codes, in order to facilitate instructions to authorizers and to prevent customers from gaining that information should they by chance see such papers on the credit manager's desk.

Notification of Accounts Granted.—Some method should be provided in each store notifying the applicant that the account has been granted or refused. The method of imparting such information differs with different houses. Some stores confine themselves to a formal and dignified letter, while others are very elaborate, praising the customer for his wisdom in opening a charge account, etc. Proper notification should also be sent simultaneously to the bookkeeping, auditing, and collection departments, so that they may be informed of the establishment of the account.

Declining Doubtful Accounts.—If an application is turned down because of adverse or insufficient information, an explanation should be made by the store. A letter, to the effect that while the references given speak very well of the applicant they are not sufficient to justify opening an account, and that it is regretted that it is not possible to comply with his request, will answer the purpose in most cases. Additional references may be furnished as a result or the name of a party may be submitted who is willing to guarantee the account. Usually, however, no reply is made, for, if the customer has been slow and unsatisfactory as a credit risk, he probably knows the reason for being turned down and will not, therefore, ask for an explanation.

If an explanation is demanded, it is advisable to state frankly the conditions disclosed by the investigation and that the store does not wish to have on its ledgers accounts running beyond a certain length of time. Should the customer insist on knowing the source of information to the effect that he was slow-pay, etc., the credit manager may, with permission of the firm involved, mention the name of that firm whom the applicant is owing, and, if properly done, the customer might make remittance and thus clear up the past credit record. In many cities where retail credit bureaus are maintained, applicants whose accounts are turned down, are not infrequently referred to the bureau for an explanation. There he is shown a record of his charge dealings with the different houses, and is caused to appreciate the value of a good credit reputation.

Irrespective of the reason for declining an account, great care should be exercised in conveying the decision to that effect, so as not to lose his patronage and good will. The denial must, therefore, be couched in careful language, the explanation made with earnestness and without abruptness and offense.

AUTHORIZING CHARGE PURCHASES

Once an account is established, one of the most important duties of the credit department is to devise a system for the handling of charge purchases such as will exercise as complete a control as practical over them. If the system used in authorizing charge purchases is poor or inadequate and errors creep in at frequent intervals, the success of the credit department, together with the reputation of its manager, is seriously jeopardized.

Proper consideration of authorization routine and responsibility obviously calls for a distinction between "charge taken" and "charge sent" purchases. Accordingly, each of these will be given separate treatment.

Authorizing "Charge Taken" Purchases.—The practice of authorizing "charge taken" purchases differs widely with different retail establishments, depending upon whether control of authorization is centralized or decentralized and the degree of decentralization of such control.

Because of the large size of many department stores and the resulting complexity of organization, it is frequently impractical to establish a perfectly centralized control over the authorization of every amount charged against each credit customer. To establish such strict control, it would be necessary to post immediately every amount authorized so as to reveal the exact condition of an account at any given moment. Since it is rarely possible to maintain records in such shape, except at prohibitive cost, or when the bookkeeping department is located nearby, it is doubtful whether a strictly centralized control can be established and maintained.

Identifying Charge Patrons.—In view of the foregoing, as well as for the convenience of shoppers, it is necessary to divide responsibility for authorization so as to prevent fraudulent purchasing and at the same time to accelerate the speed of authorizing work. Where this responsibility is divided, one of the essentials to authorizing "charge takes" is the proper identifica-

tion of the purchaser as a patron with a charge account in good standing, or one who is entitled to buy for such a customer. It is not at all unusual for servants, children, relatives, or friends to buy on the account of a credit customer. If no special and definite instructions are given regarding these persons, it is usually advisable to watch such purchases and in any event to have them confirmed by the authorizer.

The responsibility for identification of "charge taken" purchasers devolves in the majority of department and specialty stores upon the floormen; in other establishments, buyers and other store executives are charged with this duty; and still others permit some clerks in certain or all departments to exercise this power. Obviously, the method employed by any one house will depend largely upon the degree of decentralized control over authorization; also upon the means of identification adopted by the concern. Under all circumstances, however, there is a definite limit as to the amount that either floormen, buyers, other executives, or salespeople may authorize without referring the matter to the regular authorizers or the credit manager.

Methods of Identification.—Some stores have provided possessors of charge accounts with numbered metal coins, which serve to indicate authorization to purchase within certain limits. The customer is expected to bring this coin each time he desires to do some shopping, or to hand it over to the person who is to buy on the account. Under such system, floormen and salespeople are permitted to have the coin act as the sole and absolute means of identification and need not use any judgment in the matter, provided, of course, that they are kept informed through daily memoranda or lists of the numbers of the coins that have been withdrawn or which are subject to special instructions. From the customer's standpoint, the coin system is advantageous, because it obviates the necessity for further identification and consequent delay and embarrassment.

Notwithstanding these advantages, the system is not without its objectionable features. Many persons frequently do not bring the coins with them. In such cases, it usually devolves upon the floorman to use his judgment, a thing which is supposed to be obviated by the system, either in authorizing the purchase or referring the customer to the credit office. Because of this, some people postpone some of their shopping whenever they have forgotten their coin. Other customers dislike the idea of carry-

ing coins with them. Finally, there is a possibility of coins being lost. If found by unscrupulous individuals, purchases will be made on that basis to the detriment of the store.

Another method somewhat similar to the one just described is that of supplying each credit customer with a numbered card or ticket. This card usually contains the firm name and address; the customer's number; and a statement to the effect that the card is registered, that it extends privileges of an open account, and that settlement is to be made at certain dates or intervals as the case may be. On presentation of this card, a customer can secure merchandise if the account is in good standing without having to be referred to the credit department. When a card system of identification is employed, a letter explaining its use and purpose and soliciting cooperation in the matter is forwarded to the customer when an account is opened. These cards, not unlike the coins, are good only for ordinary purchases. When large amounts are involved, authorization must be secured from regular authorizers or from the credit manager himself.

Besides the advantages of preventing delay and ill feeling of customers, and of providing a simple method of accelerating the speed of handling ordinary charge purchases, the system has the added advantage of flexibility. In using this system, customers may be classified according to the amount which they are ordinarily allowed to purchase, this limit being designated by a letter following the customer's number. Thus, all patrons entitled to $5 credit at any given time on ordinary purchases will be designated by the letter A; those entitled to $10 credit will be designated as class B customers, etc. It is also advisable under this plan that each class, for the sake of simplicity, have its own series of numbers, each beginning with No. 1.

Since the same disadvantages which have been enumerated in connection with the coin system of identification and authorization apply here with equal force, many retail establishments have adopted "a signature and floorman" method. The customer is required to sign his name on each sales check, which is to be identified by comparison with his signature on one of the records in the credit department. The floorman's signature merely indicates that he identified the customer to his entire satisfaction. In still other stores, as already referred to, floormen, clerks, buyers, and other store executives are permitted to identify charge customers. To do so, it is necessary to ask the

customer for some means of identification, which the majority of people can conveniently furnish, such as a letter addressed to the person having the charge account, a calling card, or some other similar sign. If in doubt, it is, of course, necessary to refer the patron to the office or to consult a regular authorizer.

Centralized Authorization.—Practically all of the larger houses have two or three sets of authorizers. These are known as "tube room" authorizers, authorizers stationed in the delivery department, and "refer authorizers." The last type is found in the credit office proper and is in direct charge of the credit manager or his assistant. In some houses, particularly the smaller ones, all charge purchases are sent to the delivery department by means of carriers, messengers, or salespersons, for authorization. In the larger houses, where a complete tube system can be installed, sales checks are sent to the "tube room," or, when necessary, to the "refer" authorizer's desk. Still another group of concerns employ telephones with electric stamp attachments.

Authorizer's Records.—In order to prevent accumulation of packages and clogging in the delivery department, and to permit customers to obtain their purchases with the least delay and embarrassment, it is essential that authorizing work be done quickly and promptly. Hence arises the necessity for such a system of filing customers' names and addresses as will facilitate quick reference. Accordingly, several visible filing systems are to be found in operation in some of the larger successful concerns. Some of them will be briefly described in the following paragraphs.

The filing system which is still found in use in the majority of the smaller and medium-sized retail institutions consists of a 3 by 5 index card placed in one or more drawers, and filed vertically in accordance with a decimal system of numbers and split letters. This system is not adapted to large establishments, however. It is too slow and inaccurate. There is always the possibility of cards being misfiled, particularly when handled in large numbers. Furthermore, it does not show at a glance all the information desired. For these reasons visible records have been substituted, which show at a glance all the essential data an authorizer wants to know, namely, the full name, address, limit, and special instructions. All of this information can in most cases be shown in one line.

Two of the most important visible filing systems used by authorizers are the "flat-drawer" type and the "tube-design" type. Where the former system is employed, cards are arranged in strict alphabetical order and laid out flat in flat drawers, of which there are about 16 to a section, each drawer properly ear-marked. The chief merit in this system lies in the fact that it obviates the necessity of thumbing over lists of cards and it shows all the essential data at a glance.

The tube filing system consists of narrow, transparent celluloid tubes, filed in book form on rotary stands. In each of these tubes a single line of paper containing all the essential information which authorizers are required to know is inserted. If additional information concerning a customer is desired, two tubes can be used. This system, not unlike that previously described, is extremely elastic and is subject to unlimited expansion by the addition of more panels.

Many concerns also have in the delivery department a cross-index of customers' names. This is a duplicate of the original index, but names are classified by towns and streets and the system is, therefore, known as a location or geographical file. Much unnecessary delay is thus avoided in case of a faulty or illegible spelling of names when referred to this cross-index.

It is generally considered good practice for authorizers to keep records of their work, so as to make possible intelligent planning for improvements. These records will show the number of charges passed daily and the number reserved until the day following. In addition to this information, the "refer" authorizer should have records showing purchase and payment habits of the account; ratings; restrictions, if any; extra or special instructions; reference number of folder file; and the signature of the customer.

Systems Used in Authorizing Charge Purchases.—Where accounts are authorized in the delivery department, hand stamps are generally used, containing the appropriate symbol, date, and the initials of the authorizer. If authorizing is done in the tube room or in the credit department, perforating machines may be used, or an electrical stamping device employed instead.

In general, there are two mechanical systems used in authorizing charge purchases from a central point. These are the pneumatic tube and the electric telephone system, the latter being sometimes referred to as the O K telephone system.

The Pneumatic Tube System.—Under this system a number of inspectors' desks are placed throughout the store at certain strategic points. Each of them is equipped with a complete tube station. In case the tube system is used in conjunction with a central cashiering station, the carriers must be distinguished by some color. Thus, in many stores using this system, cash sales checks together with the cash payments are carried in gray-capped purses or carriers. These are opened and handled by the cashier and the change, if any, together with a sales check for customers, returned by way of the cash carrier belt conveyer, moving along the desk of the cashier to the carrier return dispatcher and thence to the department making the sale. Charge sales checks are carried in red-capped purses, which are relayed in the tube room to the credit office, unless a charge authorization section is located in the tube room, which is very often the case. To distinguish further between "charge taken" and "charge sent" purchases, the entire carrier of one or the other may be painted red or any other color. In this manner, it is possible to give preference to those transactions which require immediate attention.

When personal checks are offered in payment, they may be approved by floormen or department managers, if within certain limits, and handled as cash transactions. Should these limits be exceeded, the bank checks are forwarded, together with the sales checks, to the charge authorization desk, and, if approved, a rubber band is placed around the carrier. The rubber band signals the cashier located in the tube room to open the carrier and handle the transaction as a cash sale.

The original sales checks are placed in bins as soon as approved. From these they are collected at frequent intervals by messengers from the bookkeeping or auditing department. In this manner practically all the charge sales are posted in the ledger and otherwise handled by the auditing department during the day the sales are made.

Electric Telephone System.—The equipment of this system consists of (1) stamping perforating telephone units located in the different selling departments throughout the store; and (2) authorizer's telephone switchboard. The former are also known as "charge phones" and "O K telephones."

In using this system, the salesperson inserts the charge slip in duplicate in an electrically operated device with telephone

connections, and presses a button to signal the authorizer. When the signal is answered by pressing the "ringing" button on the switchboard, which causes a buzzing sound on the calling phone, the salesperson telephones the name and address of the customer and the amount of the purchase. If the sale is approved, the authorizer presses the "stamping" button on the switchboard, which causes the electrically operated device connected with the calling telephone to perforate on the sales slip, original and duplicate, the "charge phone" number, the date, and the O K or C H. (the latter meaning charge). Not over a few seconds elapse in such conversation and the package can be immediately given to the customer. In case the charge is not approved, the salesperson is so advised over the phone; in this event the customer may be asked to see the credit manager, or such other instructions may be given as is deemed advisable.

Authority of Authorizers.—The authority of all but the "refer authorizers" is clearly defined and limited. Only charges not exceeding certain amounts or percentages of the limits assigned by the credit manager may be passed by them. All cases showing irregularities, as where accounts are restricted, or where the names or addresses do not tally with those on record, must be referred to the "refer authorizer," who, as already indicated, is frequently an assistant to the credit manager.

Authorizing "Charge Sent" Purchases.—When charge purchases are to be delivered, the problem of handling them is greatly simplified. It not only obviates the necessity of providing means for identification, but it also makes possible authorization at a central point. If the purchases are within certain limits, they are likely to be authorized in the charge authorization section located in the delivery department. If a large amount is involved, or if alterations are to be made, the sales check is sent to the refer authorizer in the credit department or the charge phone may be used for the purpose.

WATCHING THE ACCOUNT

Once an account is accepted, a credit limit is immediately determined. To guard against running up charge purchases beyond this limit, and in order to obtain and file all relevant facts pertaining to the account, it is essential that a good credit office system be established. Such a system should provide means for securing and filing all credit information in a manner which

will make the data available for quick reference. It should facilitate the handling of changes of condition and address in order always to keep the files corrected. It should provide an automatic check on customers when the limit is approached too closely with a possibility of exceeding it. Finally, a good credit department system should have definite means of keeping the proper department informed concerning changes in residence, deaths, divorces, changes of names by marriage or otherwise, and any other changes which would affect the mailing lists or which offer possibilities for soliciting patronage effectively.

Credit Department Records and Forms.—As the applications are received during the day, they are turned over to a clerk who is charged with the duty of conducting the necessary investigations. When the information concerning applicants is collected, it is placed, together with the application blank already filled out by the applicant, before the credit manager for final consideration as to whether or not the account should be opened. If accepted, a limit or rating is assigned and a card or folder prepared for the credit department files. Probably one of the best systems is to keep the information in a folder, filed in two-column drawers. All essential information is then typewritten on the outside, while the original application blank, together with replies to inquiries and other data, is enclosed within the folder. These folders differ widely in regard to size and particularly with respect to the information placed on the outside. The simpler forms contain spaces for information similar to that appearing on the application blank. In addition to this, there is usually a space for recording special instructions concerning the account. These instructions usually deal with restrictions, as when no goods are to be charged without a written order from the customer, or when all charges on an account are to be authorized by a certain designated person or department only; accounts may be ordered "stopped" by request of the customer or upon the decision of the credit manager, because it is uncollectible, over the limit, or until the amount owed is paid; again, an account may be reopened by request or by order of the credit manager. Other folder forms are more detailed and provide additional spaces for the classification of accounts, record of purchases by months, a summary of reports of references, list of real estate owned and encumbrances thereon, taxes paid during the preceding year, and so on. Papers which are to be kept as a part of the permanent record may be attached to one

end of the folder and other papers of a temporary nature to the other end. The latter are usually destroyed when the folder is revised, generally every six months.

A significant measure which enables a credit manager to keep watch over his accounts is afforded by news clippings. Hence every credit department of a house of some size should have a clipping clerk to record all relevant data pertaining to accounts carried on the books. An unsuspected flow of information is thus contributed concerning business difficulties involving lawsuits, judgments, foreclosures, and bankruptcies; bad checks; marriages, divorces, separations, and deaths; and records of real estate transactions and registering of deeds. All of these points are at times very illuminating and invariably shed some light on the affairs of a customer. Some of them may indicate substantial changes in a customer's financial responsibility of a favorable or derogatory nature, which no creditor can afford to overlook. Should a customer be thus found to be involved in some sort of trouble, the practice of credit managers is to place a danger signal or "flag" on his record and perhaps suspend credit accommodations until a thorough investigation has been made, which may lead to the removal of the danger signal or to a closing of the account.

Every credit department should be provided with a form for passing instructions to the authorizers. As has been previously pointed out, accounts may be restricted for various reasons, requiring changes in the indexes of the authorizers' records. Authorizers should be informed of these changes with the least possible delay. This may be accomplished by the use of a form which has sufficient space in which are printed in abbreviated form all possible changes and instructions, thereby necessitating merely the insertion of the name and address of the account and several check marks opposite the appropriate spaces in the form.

Relation to Bookkeeping Department.—To exercise effective control over the numerous accounts handled by a large retail store, it is essential that the greatest cooperation exist between the bookkeeping department and the credit department. Where the credit manager is also head of the bookkeeping department, all possibility of lack of harmony is at once eliminated. Under all circumstances, the bookkeeping department must furnish the credit manager with all information pertaining to accounts which are overbuying, have

exceeded the limit for the first time, are overdue, or any other information that may be required.

Where the two departments are located on the same floor, it is relatively a simple matter to communicate with each other as occasions demand. However, when they are removed considerably, as when the credit department is located on the first floor for the convenience of patrons, and the bookkeeping department on a higher floor, where space is cheaper and more ample, difficulties may arise unless a proper system is installed. A usual plan, where tubes are used, is to connect the two departments by a tube, by means of which requests for information are sent from the credit department to the bookkeeping department via a tube desk clerk, who is to open the carrier, ascertain the bookkeeper concerned with the name, and dispatch the request along a wire to the proper place. As soon as the information blank is filled out, it is returned to the tube desk clerk, who dispatches it to the credit department. Where this system is used, urgent requests are made out on colored blanks so as to receive preference in treatment.

In addition to answering these special requests for information, the bookkeeping department reports daily all cases which are out of the ordinary, particularly when the limits assigned have been exceeded, thereby checking automatically a customer's activities. Immediately after the posting for the day has been completed, sheets are made out, usually one for each letter of the alphabet, on which are entered the name, address, account number, limit, amount owing, and date of last payment on accounts overbuying or past due. Upon receipt of these sheets, the credit manager determines upon the action to be taken, whether the account should be stopped, the limit changed, or the continuation of purchases permitted. All changes are indicated by marks or symbols placed opposite the names in question, that fact recorded on the credit folder, the sheets returned to the bookkeeping department, and memoranda of changes sent to the various authorizing sections.

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PART IV

TECHNICAL AND LEGAL ASPECTS OF COLLECTIONS

CHAPTER XXI

COLLECTION METHODS AND POLICIES

Purpose and Functions of the Collection Department.—All credit transactions involve a transfer of commodities and services for a promised equivalent payable at a future time. To secure this equivalent, practically all business organizations that sell on time are compelled to maintain a collection department or otherwise to perform the functions of such a department. This is so because not all debtors pay promptly the bills they have contracted. Even many good customers need to be reminded of their delinquency in taking care of their obligations. It is but human nature to postpone payment and put off the inevitable day of reckoning as long as possible. Some customers are forgetful; some are unable to meet their obligations at maturity, because of sickness, mismanagement, or other unforeseen contingencies; others never had any intention of paying their debts. To secure payment of accounts that are past due because of various reasons is the chief purpose of the collection department.

The efficiency of a collection department, however, is not to be measured by the percentage of collections alone. It is relatively easy to secure payment of approximately 100 per cent of all overdue accounts merely by sending to all delinquent debtors a drastic letter threatening legal action. Almost all debtors would no doubt pay their obligations immediately, but almost all of these customers would also discontinue their patronage. Hence, the importance of securing a maximum of collections with a resulting minimum loss of trade. The second object is not only no less important than the first but may easily become of greater significance because the profit derivable from future transactions with a delinquent debtor may greatly exceed the amount due on a particular bill. Nevertheless, the first object is extremely vital, for failure to collect the full amount due will cause the customer to take advantage of the credit grantor's leniency and make future dealings troublesome.

Thus the problem of the collection department or collection

man is to collect the overdue accounts without at the same time offending the customer, a task far from being easy of achievement. If the customer is pushed too hard, there is danger of repelling and losing trade. On the other hand, there is the possibility of treating him so leniently that he becomes careless and in this manner makes his accounts cost more to collect than they are actually worth. Because of this dilemma the average merchant is led to believe that collections are a hopeless task, or else he feels that it is a problem extremely difficult to solve. To be sure, it is no easy task to determine upon the maintenance of so nice a balance as to result in the collection of the largest possible number of overdue accounts as quickly as feasible and at the same time lose as few customers as possible.

Importance of Prompt Collections.—It is impossible to overemphasize the value of constantly but properly driving after money due and not paid in time. Profits are dependent to no small extent upon the number of times a merchant can turn over his invested capital, and prompt or "close" collections are invariably accompanied by a rapid capital turnover. The rapidity with which a merchant may turn over his working capital, for example, depends partly upon the rapidity with which he can market his products and partly upon the rapidity with which he converts his accounts receivable into cash. Furthermore, prompt collections increase the working capital of credit grantors and save them large sums in bank interest, whereas slow collections cause a loss in the use of a concern's capital which is tied up in past-due "outstandings." Prompt collections are also vital to concerns because they are enabled thereby to take advantage of discounts offered for cash payments on purchases. Concerns with a limited line of credit at the bank frequently find it impossible to borrow further sums with which to discount their bills. It is, consequently, essential from their standpoint to collect overdue accounts as promptly as possible in order to effect savings incident to discounting bills for purchases. It should also be remembered that insufficient working capital is responsible for practically one-third of all business failures. This lack of capital can be traced in many instances either to indiscriminate credit granting or to inefficiency of the collection department, or both. Slow collections are, therefore, apt to cause undue embarrassment to credit grantors through insufficiency of working capital.

Two other significant results are obtained by a proper policy of enforcing prompt payments. In the first place, a debtor whose account is already overdue is not likely to place additional orders with such house. Instead, he will be encouraged to buy from houses where his credit standing is unimpaired. The effect of such action is to diminish the volume of sales of those houses which allow their debtors to run up large overdue accounts and to increase the sales volume of concerns more drastic in their collection methods. Finally, houses are more highly respected by debtors when their accounts are closely watched and promptly collected. Customers soon learn which concern is lenient and which concern will insist that its bills be met promptly, with the result that they pay the latter and let the former wait for its money. Hence, the importance of training customers to pay their obligations promptly. When this aim is accomplished, the collection department has less actual collection work to perform than the inefficient department whose lack of system is responsible to no small degree for the negligence of its customers in paying their bills according to terms of sale.

Classification of Debtors.—In order to handle customers rapidly and intelligently, they are generally divided into three classes, consisting of good risks, fair risks, and poor risks.

The good risk is a customer who is highly rated in regard to his financial ability to pay and is so eager to keep his credit intact that he will make satisfactory arrangements the moment he finds himself unable to meet his bills. He is a good-pay customer, has a high credit limit, and is entirely reliable. Such a customer must be treated with the utmost courtesy in case of delinquency. A little pressure and a proper appeal may be all that is necessary in order to bring about payment of the bill. The delinquency is in all probability due to negligence and not so much to lack of financial resources. Customers in this class are highly sensitive; the treatment must be mild, lenient, and courteous, lest they become offended and withdraw their patronage. No drastic measures whatever need be resorted to and the time between the various letters in the collection series is the longest allowed for the various classes of delinquents.

The fair risk is a customer who is probably good but slow. He has a medium rating in regard to his ability to pay and is entirely willing to meet his bills, but through carelessness or through the happening of unforeseen contingencies beyond his

control, he postpones payment of his obligations. Such customers have a medium credit limit and, in spite of their occasional delinquency, do not belong to the dishonest category of debtors. They constitute the largest percentage of a retail store's accounts and form the large body of small merchants over whom the credit manager must keep close watch. Many of these delinquents may be finally educated into the first class of debtors. Because of their honesty and good intentions, these cases require careful and special consideration, necessitating a study of conditions responsible for the delinquency before pushing the claim and thereby adding to the confusion and embarrassment of the debtor and further delaying payment. The collection system must allow a longer period of time to elapse between the various letters of the collection series and other methods forming a part of the anticipated plan.

The poor risk is a customer who apparently has just enough ability to pay and just enough reputation of meeting his obligations with fair promptness to deserve the privilege of an open account involving a small credit limit. In this class are included those customers who can pay but do not intend to do so until forced, as well as customers without conscience or financial responsibility, commonly known as professional "deadbeats." So long as these risks are kept within the credit limit placed on their accounts, they may pay with fair promptness. No credit manager can be certain that he has not extended to some of them more than is warranted by actual conditions, partly because of failure to investigate a customer's reliability thoroughly and partly because even the most careful investigation sometimes fails to disclose the weakness of an applicant for credit. Among these delinquents are persons who are absolutely indifferent to unfavorable credit opinions and upon whom "duns" all the way from pleading persuasiveness to threats to take drastic action have no effect. In dealing with these accounts, the collection system must operate rapidly. Little time should elapse between the first notification and the letter threatening suit. No sympathy should be shown to persons who have earned a reputation as chronic bad-pay customers, because such risks are habituated to strict treatment and will take no offense at the promptness with which they are followed up. Drastic treatment should be reserved, however, until the credit manager has overwhelming proof of the unworthiness of the delinquent. Otherwise, persons

in this class should be treated as if they belonged to the class comprising the fair risks.

In view of the foregoing, it is apparent that each of the three classes of delinquent debtors requires somewhat different treatment. It is, therefore, essential to ascertain the reason for the delinquency as early as possible in the collection proceedings, so that each account may be properly classified and accorded the treatment which that class deserves.

The value of a debtor's future patronage and his past record with the house should always be given adequate consideration in determining upon the course of action to be pursued in enforcing payment. Obviously, it is to the interest of a credit grantor to give more consideration and relatively lenient treatment to one whose annual patronage is worth $5,000 than to one whose trade is limited to $500 per year. It is equally obvious that a customer who has been prompt in meeting his obligations in the past should be shown more consideration than one with whom past experiences are few or unsatisfactory.

Value of a Collection System.—Notwithstanding differences in treatment of various classes of delinquents, it is nevertheless possible and essential to have a proper system for insuring the prompt and orderly handling of accounts when they become due and for preventing them from being overlooked. To be sure, the most efficient method of collecting delinquent accounts is the one which affords individual treatment to each of these accounts by someone who is thoroughly acquainted with the debtor and with the reasons for his delinquency. In large organizations in which thousands of accounts must be kept under the constant supervision of the credit or collection manager, the method is entirely impractical and some sort of a system must be employed. Haphazard methods in following up accounts inevitably lead to carelessness and neglect on the part of debtors to make remittances, and, incidentally, invite losses. Such methods also preclude the possibility of clerks handling matters of mere routine without first consulting the credit manager. The collection system is a regular method or order of procedure whereby the pressure on delinquents is increased gradually but surely until payment is received or until a climax is reached in the use of forceful and drastic means. It is more or less mechanical and automatic in regard to the various steps to be taken and in respect to the dates and types of collection notices, letters, and

so on. The system adopted should nevertheless be sufficiently flexible so that in its operation due allowance will be made for differences in personality, past record, financial condition, and the value of future patronage of debtors. It should not be so rigid as to cause the credit or collection manager to sacrifice his individuality and allow his work to become a mere mechanical process. Thus, its effectiveness lies in its flexibility and cumulative effect. The impression made upon the debtor by one step or process of the system should be deepened by the next step or process until remittance is made or the account written off as bad and uncollectible and finally placed in the graveyard where all the unfortunate mistakes of the credit manager are buried.

Importance of Promptness and Regularity.—Whatever the system employed, it should provide for promptness in reminding a customer of his obligations and for regularity with respect to the dates when some form of collection effort should be made. If considerable time elapses between the date of purchase and that on which he is reminded of his obligation, the effect is to allow the debt to fade from the customer's mind and to give little thought to the delinquency. Too great an interval between the various other steps in the collection series has a similar effect. Few customers, if any, will object to being reminded of their obligations, provided the reminder is prompt, regular, and courteous. On the contrary, a house which pays business-like attention to the collection of its accounts gains the respect of customers. Furthermore, such procedure helps to keep debtors in a sound and healthy financial condition. The effect of this is to increase sales, for, when customers know they do not have a long overdue account at a certain house, their conscience is easy and, knowing that they will be welcome, they take satisfaction in buying from that concern.

FOLLOW-UP SYSTEMS

The Ledger Plan.—To facilitate following up overdue accounts and to avoid mistakes, a careful record should be kept of all collection efforts made, so as to place before the collection manager or his clerks and correspondents all the necessary information on a specific item for intelligent action. Not a little of the success in collecting may be attributed to a good follow-up system. To accomplish this end, several devices are employed.

Of these the three plans of recording such data, and making it accessible when needed, are the ledger system, the card tickler plan, and the duplicate invoice method.

Where the number of accounts is small, and even in some large business organizations, credit managers prefer to inspect the ledger at frequent intervals, possibly every week or twice a month, in order to learn the exact status of each account. A standardized series of notations is then made on the ledger opposite each overdue account of all steps taken in enforcing payment. The chief advantage of this plan lies in the ability of the credit manager to keep better posted on the progress and development of each account carried on the books. Furthermore, this system obviates the necessity of keeping a separate record from that appearing on the ledger as is required by the use of any other plan. One record suffices for both the bookkeeping and collection departments and duplication is completely avoided.

Obviously, such plan of following up overdue accounts is confined to the smaller houses and to those concerns in which the credit and bookkeeping departments are located side by side. Where the number of accounts is considerable, the advantages claimed for the plan are more than offset by its disadvantages. The chief of these disadvantages is the possibility of sending out statements and making other collection efforts in an haphazard manner and at irregular intervals. There is an incentive for the credit manager to defer running through the ledger until all other matters are disposed of. Thus the work of following up accounts becomes secondary in importance to the other functions of the department, with the result that collections are neglected and eventually become slow and difficult. Moreover, while it is desirable that a credit manager become acquainted with the development of all accounts carried, an inspection of all of them at frequent intervals imposes on him a burden too heavy to carry. Much of the time thus consumed could no doubt be spent to better advantage handling more serious and difficult credit problems. Then, too, an inspection of the ledger at frequent intervals necessarily involves constant interruption and delay to the work of the bookkeeping department. It also causes a loss of time to the credit manager in going back and forth from the credit to the bookkeeping department in order undue embarrassment to credit grantors through insufficiency of working capital.

The Card Tickler System.—To overcome the objections incident to the use of the ledger plan of recording collection efforts, a card tickler system is employed. It is frequently termed the "diary dating system." It consists of two or more sets of files or folders numbered consecutively from 1 to 31. Each set represents one month, with one division or folder for each day. The aim of any such system is to provide a daily reminder to the credit manager of all overdue accounts which require his attention, by placing such matters before him in accordance with a prearranged plan of procedure.

To accomplish this result a follow-up file containing a folder for each day and divided with monthly guides is established. A separate collection card is made out for each debtor, containing the amount, terms and due date of each invoice. These cards are then arranged in the tickler files according to maturity. In this manner all cards recording invoices which fall due on a certain day automatically appear for attention on that day.

Under this system, a clerk goes through daily all the cards contained in the appropriate subdivision and checks them against the ledger, in order to determine whether payment has been made on them. Remittances received since the last step in the collection series are posted on the card and brought to the credit manager or his assistant for further treatment. If remittances have not been received, the cards are placed on the manager's or correspondent's desk, as the case may be. The proper collection effort is made and a notation to that effect is placed on the card, which is then advanced ahead in the tickler under the date set for further treatment, should the delinquency continue. The same procedure applies to all collection steps taken, including statements sent to the delinquent, all collection letters, granting of extensions, drafts drawn on the debtor, and so on, until remittance is received or the account written off as bad and uncollectible.

When all maturities on a given day have had attention, the guides or folders are rotated so that the current date is always in front. Nothing is left to chance under this plan. All matters turn up automatically on the desk at the desired time and overdue accounts are handled systematically and at regular intervals. The plan requires little labor to operate, saves the time and energy of the credit manager, and obviates all difficulties experienced under the ledger system of following up ac-

counts. It does necessitate, however, more or less of a duplication of records and somewhat additional clerical labor.

Tickler collection cards should be carefully retained for future reference, for they indicate at a glance any troublesome experiences the concern has previously had with any one customer, thereby suggesting the proper action that should be taken in case of repeated delinquency.

The Duplicate Invoice System.—This method is essentially the same as the card tickler system, except that a duplicate copy of the original invoice is substituted for the card. Where invoicing is done on billing machines it is possible to make an extra carbon copy to be used as a collection copy without any additional work. These invoices are filed in a tickler of one or more drawers, bill size, vertical style, and equipped with cardboard division cards or folders numbered from 1 to 31, according to maturities, so as to appear on the due date or a few days prior. When the invoice copy appears, it is checked against the ledger to determine whether it has been paid, in which case it is destroyed or filed permanently in the general office files. Otherwise, the prearranged collection campaign is started and every action recorded on the invoice, which is then returned to the file a specified number of days in advance, when it automatically reappears and again compels the credit manager's attention.

COLLECTION PROCEDURE

Wholesale and Retail Collections.—All the principles that apply to collecting past-due accounts of a wholesaler or manufacturer apply, essentially, to the collection problems of the retailer. The methods and procedure are similar in many respects. Both are governed by the same considerations, both attempt to collect the amounts owed them without offending the delinquents; both try to train customers to pay their bills promptly, and each one is following a general plan similar in many respects. In some ways, however, the collection systems of the two differ. These differences are due at least partly to the loose methods of credit extension on the part of retail stores, and partly to the fact that retailers see their customers more frequently. Loose methods in granting credit are obviously a source of weakness and are largely responsible for the relatively large number of poor risks carried on the books. Ability to see

the customer more often is nevertheless an advantage which, if rightly used, tends to offset the weakness mentioned. Differences in collection methods of the two institutions are also accounted for to a certain extent by the size of the accounts carried by the respective organizations.

In view of these fundamental differences, the time allowed a customer by the wholesaler or manufacturer in which to make remittance is much shorter because the credit terms are more definitely stated. Furthermore, a wholesaler stresses the appeal to self-interest in his correspondence with a delinquent, because his customers are themselves engaged in business, and usually realize the importance of keeping their credit standing unimpaired. Retailers, on the other hand, sometimes obtain most satisfactory results by placing chief reliance upon appeals to justice and sympathy.

Again, drafts are quite commonly used by wholesalers, but seldom employed by retail stores as a means of enforcing payment. Finally, wholesalers make greater attempts than do retailers to induce debtors to make part payments, probably because the amounts involved in many of the accounts carried on the books of the former are much larger. For the same reason, many more requests for extensions are received from delinquent customers of wholesale concerns. Retailers, on the other hand, are loath to encourage part payments, because it is rather difficult later to object to this method of settlement once a customer has been allowed to develop the habit.

Statements.—Regardless of the collection system employed, the first step consists of sending a bill at the time the goods are shipped to the customer. This step is then followed by sending statements. Practices differ widely with respect to the time such statements are sent. Some houses have adopted a "monthly statement" plan, under which statements are sent to all customers once a month, usually on the first. Where the accounts are not yet due, they serve as a reminder that remittance is expected when due. These statements are mailed directly by the bookkeeping department. Those covering overdue accounts are submitted to the credit manager or his assistant, and a stamp is applied to the face of the statement with the wording "Past due; please remit," or other words to the same effect. Printed reminders with reference to accompanying statements are used by some houses, while in still others a different style of make-up of

formal notifications is employed; this may consist of a printed, typewritten, or multigraphed form containing blank spaces to be filled in with the name and address of the customer, the date and month in which the purchases were made, and the amount owed. The purpose of all of these notifications is to call the matter to the attention of the recipient. These reminders should be courteous, because the first proper assumption to make when an account lapses into slowness is that the matter has probably escaped the customer's attention.

Houses operating under the monthly statement plan sometimes forward two or three such reminders before proceeding with the next step in the series. The usual plan is to make out a tickler card for the follow-up system, as soon as the first statement is forwarded, bearing the rubber-stamped notation or accompanied by some formal notification.

The chief drawback of this plan is that the overdue accounts are brought to the attention of the credit or collection manager only at certain definite intervals, with the result that negligent debtors are not trained to make prompt remittances, while dishonest debtors are afforded too much time, thereby enabling them to perpetrate contemplated frauds against their creditors. Furthermore, it has been proved almost conclusively by the experiences of a number of houses that merchants who are able and willing to pay strictly at maturity will do so without a reminder in the form of a monthly statement, and those who are chronically slow will require a statement at maturity anyway, regardless of whether they have received a form statement on the first or not. Much could be saved in time and expense if monthly statements to all open accounts on the ledger, save overdue accounts, were entirely eliminated.

Many houses have adopted a plan which requires that, in addition to monthly statements forwarded to all customers whose bills are not yet due, other statements be sent to all debtors immediately after the accounts became due. The former serve as reminders that the bill is becoming due and assist the debtor in bringing about an understanding concerning differences that may have arisen respecting the amount of the bill and also forestall any possible excuse that the matter has slipped his attention; while the latter serve as an indirect demand for payment and become more forcible and effective by the various styles of notification which accompany them.

Collection Letters.—The next most commonly used method in collecting overdue accounts is the collection letter. It is probably the most satisfactory of all methods available in accomplishing the general results sought, namely, of bringing previous transactions to a satisfactory end, and of paving the way for future business by developing good will. Because of the tremendous importance of letters in collection work, the whole of the following chapter is devoted to the subject.

Collecting by Drafts.—The draft is quite commonly used by wholesalers and manufacturers as a means of enforcing payment. It is one of the more urgent steps in the collection series. In some lines of business the first or second letter may be followed by a draft; in other lines of trade the terms of credit stipulate that if the account remains unpaid after a certain time, a draft will be drawn upon the customer without further notice. It is not the common practice in most branches, however, to resort to the use of drafts until after all collection letters have failed to bring the desired response. Since the draft is one of the more forcible methods, except in trades where payment is commonly made by draft, it is generally advisable to call the customer's attention by letter, in advance, of the intention to draw upon him. Such letter usually contains a simple statement reviewing the steps already taken and stating that unless a response is made by a certain date a draft will be forwarded to the delinquent's bank. This will frequently have the desired effect and bring the remittance. This letter also affords the debtor sufficient time in which to prepare to meet the draft when it is presented by the bank for collection. Sometimes a sharp letter may be sent with the notice in order to emphasize the step.

The chief purpose of drawing a draft upon a delinquent debtor is to make the bank the creditor's collecting agency, with an implied notice to the debtor's bank and locality that the drawee's credit standing is somewhat impaired. For this reason a draft should be almost as effective as a letter from an attorney or collecting agency. Unfortunately, however, the widespread use of the draft during the past few years against persons who were not really delinquents has had the tendency to weaken its power and largely to remove the sting from it. Thus, when a draft is dishonored today it no longer menaces the drawee's credit, for such act is no longer a confession of insolvency. Drafts

are returned now without any misgiving, for a somewhat different significance attaches thereto, except where they are dishonored consistently and in large numbers. Under these circumstances the debtor's credit standing will suffer particularly at his local bank. Nevertheless, the draft should never be used without due notice, for many customers still consider it a serious reflection on their credit responsibility, and once offended they are likely to carry a grudge against the house.

Although there is no way of compelling a drawee to honor a draft, such step is nevertheless valuable even when the draft is dishonored, in that it makes an urgent suggestion to pay. Furthermore, when a draft is dishonored it is usually returned to the creditor with an indorsement or notation stating briefly the reason for the drawee's failure to pay. This gives the draft a strategic value, for the way it is treated by the debtor gives the creditor information concerning the following step that should be taken. From these notations the creditor occasionally learns of the debtor's intentions, thus furnishing a better basis for further treatment. If the debtor gives the bank a reason or excuse for non-payment, such reason or excuse can be met logically in the next creditor's letter, thereby putting him in such a position that he cannot defend himself, but must either settle the claim or brand himself a bad-paying customer. If the notation on the slip attached to the draft indicates that the debtor was unprepared at the time to make payment, a second draft may be sent immediately, together with a letter announcing that fact, calling attention to the first draft and suggesting forcibly that the debtor be prepared to meet his obligation when the draft is presented by the bank for payment.

When used, the draft is either deposited in the creditor's own bank, which, in turn, forwards it to a bank in the customer's locality, or is sent directly to the bank in the debtor's vicinity. Many credit managers prefer to send the draft to the debtor's bank, if it is known; while others prefer to send it to another bank in the debtor's town on the assumption that the stranger bank will more promptly present the draft for payment. On the other hand, a delinquent is more likely to be induced to make payment if the draft is presented through his own bank. The name and locality of the bank with which the debtor in all probability has dealings may be ascertained from checks

sent by him, from mercantile agency rating books, or from law lists, which generally include a list of banks.

When the draft is collected, an exchange charge is made by the bank, otherwise nothing is charged for the service. Since, however, the increased use of drafts in the collection of accounts caused many to be returned unpaid, the service became increasingly burdensome, so that now many banks refuse to handle drafts free of charge. In order to cause banks to give more careful attention to the presentation and return of drafts, with notice of reason for non-payment when the draft is dishonored, it is advisable that a small fee, anywhere from 10 to 25 cents, be enclosed with the draft.

Why Drafts Are Returned.—Drafts may be returned unpaid for one or more of the following reasons. The bank may have neglected to present the draft. Some debtors may be temporarily out of funds and unable to meet their obligations at the time the drafts are presented for payment. Many debtors resent the use of drafts drawn upon them and show their attitude by ignoring them. They may consider payment by draft as a serious reflection on their credit and, consequently, prefer to make remittance by other means. Finally, there are debtors who are either unable to pay their bills or unwilling to do so.

The Personal Call.—Next to the collection letter, the personal call is probably the most common method of collecting overdue accounts. This method is more commonly employed by wholesalers and manufacturers than by the retailer, save retailers selling on the instalment plan, so much so that many wholesale houses rely almost entirely upon their salesmen to make the necessary collections from customers in their respective territories. In this manner, no extra expense is involved, for collections are made by the salesmen during their regular visits. Then, too, because of their intimate knowledge of customers and circumstances, they often make good collectors.

In the ordinary retail trade, personal collectors are becoming more uncommon because of the expense involved in sending personal representatives to collect small bills, and partly because of the practical impossibility of securing collectors who combine the various essential characteristics in the correct proportion for the salary which is ordinarily paid for such services. Poor collectors are sometimes worse than none, for at best they only injure the customer's good will. Personal effort is fre-

quently effective, however, after the resources of correspondence have been exhausted. For this reason, collectors are still to be found in some of the larger retail concerns. Where goods are sold on the instalment plan, personal collectors are commonly resorted to as a means of collecting both due and overdue instalments. In general, collecting by personal representatives is much more efficient than any of the other methods available, as far as the actual sums collected are concerned. In a majority of cases, however, it results in a loss of trade and good will, which more than offsets the advantage of collecting a larger percentage of overdue accounts, except where it is customary so to collect accounts.

Where the salesmen of a wholesale house fail in their efforts to collect an overdue account, and assuming that a draft upon the debtor has been dishonored, the next step would be to hand over the account to an attorney or collection agency for further and more drastic treatment. If the amount involved is considerable, however, and the good will of the delinquent important, a personal visit by the credit manager himself is highly desirable, provided the distance to be traveled is not too great.

Before calling upon the debtor, the credit manager should be prepared with all necessary information. He should ascertain from the files the exact circumstances in the case and characteristics of the person whom he is to visit, for he has a particularly difficult task to perform, namely, of convincing the debtor that the bill must be paid without, at the same time, antagonizing him and thus losing his good will and future business.

Attorneys and Collection Agencies.—After all means have been exhausted, and assuming that the creditor stands ready to sever his business relations with the delinquent, a letter is sent to the debtor threatening to place his account in the hands of an attorney or collection agency unless remittance is received within a specified time. If the delinquent customer fails to respond to the letter threatening such action, the account is handed over to an attorney or collection agency, where the collection system is taken up at the point the seller left off.

This step should not be taken until and unless all reasonable methods have failed and the debtor is no longer deemed a desirable customer. Once an account is handed over to an attorney or collection agency, all friendly relations with the debtor are necessarily ruptured beyond repair.

Methods Employed.—The methods of collection agencies and attorneys consist simply in a more forcible application of the principles underlying the procedure used by merchants themselves. They usually write one or more letters to the debtor, urging him to make payment and pointing out the unpleasant consequences of his neglect to do so. Whereas merchants are tactful and use mild means, these representatives are harsh and employ forcible means. They care nothing for keeping the customer; their only aim is to collect the account by resorting to veiled or open threats and harsh language. If the debtor lives or conducts his business in the same vicinity as the attorney or agency, a collector is usually sent to make a personal demand.

Collection Agencies.—Many credit managers prefer to utilize collection agencies in place of attorneys. The former are, as a rule, more systematic in following up accounts and usually write a whole series of letters before forwarding the account to a correspondent attorney. On the other hand, there are numerous irresponsible collection agencies which need thorough investigation before placing an account in their hands. For this reason, many trade bureaus have been formed, one of the functions of which is to collect accounts for their members. Both Dun's and Bradstreet's, credit insurance companies, and many of the Adjustment Bureaus affiliated with the National Association of Credit Men are also equipped to render a collection service for members and subscribers as well as for others. The larger agencies and bureaus are not only entirely responsible but also exercise a powerful moral influence on the delinquent debtor. Failure to pay an account placed in the hands of the large agencies or bureaus works to the detriment of the debtor, for the entire business community soon learns that fact through the credit reports which they also render. Debtors know that and are, consequently, more likely to make payment before suit is brought against them.

Attorneys.—In the case of an out-of-town claim, probably the most commonly used method is for a creditor to place the claim in the hands of a local attorney. This attorney usually makes a few collection efforts by correspondence, and if they bring no satisfactory response, the claim is forwarded to a correspondent attorney in the home town of the debtor. Under such circumstances the fee is divided, the forwarding lawyer

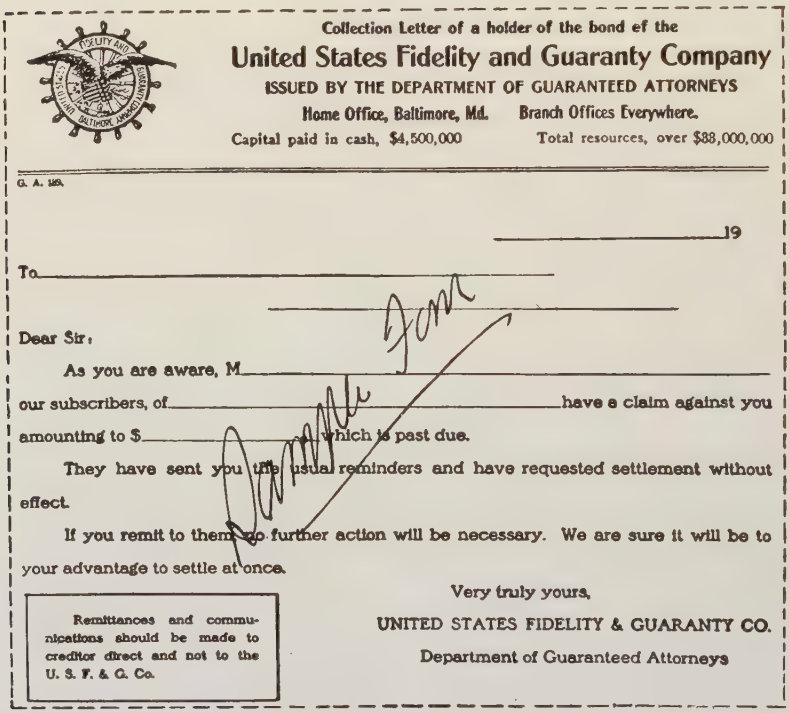
retaining one-third and the receiving attorney getting two-thirds of the total fee charged for making the collection.

Another method of placing the claim in the hands of an attorney is by forwarding it directly to a lawyer located in the debtor's town. The name of a competent and responsible attorney may be secured for this purpose through the assistance of "bonded attorney lists," "guaranteed attorney lists," or "law lists." Several concerns publish such lists and some of them assume full responsibility for any claims collected by any attorney appearing on their lists, provided the creditor complies with certain requirements of the publishing house. Some of these lists even rate each attorney on the basis of integrity, financial responsibility, ability, and promptness in remitting claims collected. Nothwithstanding all these guarantees by publishing houses, many credit managers still follow the practice of compiling their own lists of attorneys on the basis of their own investigations and experiences.

Advantages of Forwarding Attorneys.—Two distinct advantages are claimed for the method of placing out-of-town claims in the hands of attorneys residing in the city where the creditor is located. In the first place, the creditor is relieved of the necessity of carrying on an enormous amount of correspondence in order to keep in touch with the attorney and be informed as to the progress of the account, although a limited amount of correspondence must be carried on even with the attorney who resides in the creditor's town. The other advantage is that the receiving attorney pays correspondingly closer attention to claims received from a forwarding attorney and renders more satisfactory service. This is largely because a forwarding attorney has occasion to forward more claims for collection than the average creditor. The business received from a forwarding attorney thus becomes relatively more valuable to the receiving attorney, notwithstanding the fact that he receives only two-thirds of the total fee.

Agency Substitutes.—Some collection agencies, trade organizations, law list publishers, and collection letter houses have devised a series of forms of collection letters for the use of subscribers. These "fake collection agency" devices are used considerably as a last resort prior to bringing suit against the debtor. These forms are sold or given to creditors who are

subscribing for the services of the company, who fill in the blanks and forward them to the delinquent debtors. The forms bearing the name of the collecting agency, consist of a letter or a series of letters in decided contrast to the tone of the usual reminders and personal letters of the creditor, containing veiled or open threats couched in business-like and insistent language. The purpose is to impress the debtor with the idea that these letters are sent by the agency which may advertise his delin-



Collection Letter of a holder of the bond of the

United States Fidelity and Guaranty Company

ISSUED BY THE DEPARTMENT OF GUARANTEED ATTORNEYS

Home Office, Baltimore, Md. Branch Offices Everywhere.

Capital paid in cash, $4,500,000 Total resources, over $38,000,000

G. A. 129.

_____ 19

To _____

Dear Sir:

As you are aware, M_____ our subscribers, of _____ have a claim against you amounting to $_____ which is past due.

They have sent you the usual reminders and have requested settlement without effect.

If you remit to them no further action will be necessary. We are sure it will be to your advantage to settle at once.

Very truly yours,

UNITED STATES FIDELITY & GUARANTY CO.

Department of Guaranteed Attorneys

Remittances and communications should be made to creditor direct and not to the U. S. F. & G. Co.

FIG. 34.—First collection letter of a holder of the bond of the United States Fidelity and Guaranty Company.

quency, with the result that he is sometimes scared into paying the bill and it thus obviates the necessity for more drastic measures (see Figs. 34, 35, and 36).

It is quite obvious that these forms should not be used until after all other reasonable measures have failed to bring a satisfactory response or unless the account is thought undesirable and the creditor stands ready to sever business relations with the delinquent. They are recommended as a means preceding

Collection Letter of a holder of the bond of the

United States Fidelity and Guaranty Company

ISSUED BY THE DEPARTMENT OF GUARANTEED ATTORNEYS

Home Office, Baltimore, Md. Branch Offices Everywhere.

Capital paid in cash, $4,600,000. Total resources, over $33,000,000

G. A. 190.

_____ 19

To _____

_____

Dear Sir:

As you have not remitted M_____

of _____, our subscribers,

in settlement of their account against you amounting to $_____ you are hereby advised that unless a remittance is made to them at once, this account will be placed for collection with our bonded attorney for your town, for prompt action.

Very truly yours,

UNITED STATES FIDELITY & GUARANTY CO.

Department of Guaranteed Attorneys

Remittances and communications should be made to creditor direct and not to the U. S. F. & G. Co.

FIG. 35.—Second and last collection letter sent by a holder of the bond of the United States Fidelity and Guaranty Company.

BRANCH OFFICES:

ATLANTA, BOSTON, BUFFALO, CHICAGO, CINCINNATI, CLEVELAND, DETROIT, LOUISVILLE, MILWAUKEE, MINNEAPOLIS, NEW YORK, PHILADELPHIA, PITTSBURGH, SAN FRANCISCO, ST. LOUIS, ST. PAUL

ADVANCE NOTICE OF DRAFT FROM A HOLDER OF THE BOND OF THE

UNITED STATES FIDELITY AND GUARANTY CO.

ISSUED BY THE DEPARTMENT OF GUARANTEED ATTORNEYS,

HOME OFFICE, BALTIMORE, MD.

To _____

_____

Dear Sir:—If we do not receive remittance to cover your overdue {note / bill} by _____ 19__ we shall on that date draw upon you through _____ Bank of _____

for _____ Dollars, with instructions to Bank, if our draft is not paid on presentation, to hand our claim for collection to an Attorney who will on our notice be covered by the bond of the United States Fidelity and Guaranty Company, which we hold.

Signed _____

Holding bond of United States Fidelity and Guaranty Co.

Street and No. _____

Date _____ 19 City and State _____

FIG. 36.—Letter giving advance notice of draft to be sent by a holder of the bond of the United States Fidelity and Guaranty Company.

that of actually bringing suit, primarily because of their inexpensiveness.

Suing the Debtor.—Should attorneys or collection agencies fail in their attempts to effect a settlement by amicable means, they will in all probability ask the creditor for authority to summon the debtor into court. Before granting such authority, the credit manager should satisfy himself that the debtor possesses unencumbered property on which to levy in case a judgment is secured sufficient in amount to cover the value of the claim and expenses incident to the suit. Otherwise, he will, by advancing money for costs of the suit, be throwing good money after bad. Oftentimes, the attorney or the agency may be able to furnish the requisite information, and if *bona fide*, their recommendation concerning the advisability of suit should be followed.

Once authority to sue is granted, the credit manager must follow the case closely until the date for trial is set. If a judgment is entered, a few days are normally given the debtor in which he may make the necessary arrangement to pay the judgment, including interest charges and court costs. If payment is not made, execution of the judgment is issued to the proper court officer, who levies upon the property of the defendant. A public sale is advertised and the proceeds therefrom, not exceeding the amount of the judgment, are turned over to the attorney for the benefit of the creditor.

Should there be no property upon which to levy, it becomes advisable to docket the judgment, by filing a transcript with the county clerk, for which a nominal fee is paid. In this manner, the judgment becomes a lien against any real property which may be acquired by the debtor any time thereafter within a certain number of years, the exact period of time varying in the different states.

UNUSUAL COLLECTION METHODS

Every credit manager finds it necessary sometimes to resort to extraordinary measures in addition to the other methods used in collecting overdue accounts. These methods are so uncommon as to be unexpected and, consequently, effective. In using these methods the delinquent should be singled out and made to feel the necessity of meeting his obligation at once. This can be accomplished by using one or more of the methods described below, in case the usual procedure fails to bring re-

sults. Thus, even the most hardened offenders may be reached if sufficient originality, tact, judgment, and imagination are brought into play.

Dunning by Wire.—As long as proper precaution is taken in the wording of the telegram, dunning by wire is permitted by law. The wire should be in the form of an inquiry as to when payment will be made. Nothing which would tend to convey the impression that the debtor is a cheat, or a fraud, or that he unnecessarily or without cause delays the payment of the bill is permissible. Any such inferences might subject the sender to an action for libel. A telegram or night letter requesting an immediate explanation for the delay in sending a remittance and expressing surprise at such delay is usually a very effective means of emphasizing the importance of giving the subject immediate consideration.

Telephone Calls.—The effect of telephone calls is often as good as that resulting from a personal interview. Matters that could not be written without liability for libel can safely be talked about over the telephone, for, to prove a telephone conversation with a given person, the plaintiff must prove a previous conversation face to face, with the defendant, and swear that he would recognize that voice when heard. This is very difficult to prove, for voices in many cases do not sound the same over the telephone as in ordinary conversation. The conversation may be as short or as long as thought desirable. Several kinds of appeals may be made in rapid succession within a brief time. The only disadvantage over personal interviews is that payment cannot be secured immediately, even though the debtor's mind is brought up to that point.

Registered Letters.—A registered letter sent with the express direction to deliver it to the addressee only, and requiring a return receipt, forcibly calls to the attention of the delinquent debtor the condition of the account and gives evidence that great importance is attached thereto and that the creditor insists upon payment. Upon receipt of such a letter, the debtor will conclude in most instances that his neglect to meet the bill is becoming more serious than it previously appeared to be.

Settlement by Note.—When it is impossible to secure cash, settlement may frequently be made by notes, provided the debtor really intends to pay at some future time. In taking notes in settlement, a creditor must carefully consider, in addi-

tion to the advantages, the disadvantages incident thereto. To be sure, a note serves practically as conclusive evidence of the indebtedness and facilitates proof if suit is subsequently brought against the debtor. Furthermore, debtors have more respect for their obligations when evidenced by a written instrument. They are more likely to meet their notes at maturity than pay their debt represented by open book accounts. A third advantage is that notes may be discounted at the bank and the proceeds employed in the business. Notes are also sometimes deposited with the bank for collection. Because of the semi-public character of a bank and its position in the community, a debtor will be more apt to make arrangements to meet his obligations when the note matures.

On the other hand, many creditors who are reluctant to accept notes in temporary settlement of open accounts claim that the practice is highly objectionable. In the first place, they contend that it is not true that notes are usually paid at maturity, that it is not uncommon for debtors to offer only part payment on the due date and to request an extension of time on the balance, for which another note is tendered. This situation is particularly true of the smaller merchants. They claim that, on the contrary, open accounts are paid more promptly than notes or their renewals, especially when arrangements are made for partial payments at definite intervals.

In the second place, it is argued that the acceptance of notes in settlement of an open account establishes a bad and undesirable precedent. It later becomes somewhat difficult to take objection to this method of payment once the customer has been permitted to develop this habit.

A third argument advanced against the plan is that once a note is accepted a creditor waives all rights to demand or expect payment until the instrument becomes due. He cannot resort to any means of enforcing payment, even though such action were desirable, until the due date. Because of this fact, it becomes highly desirable for the creditor to require the debtor to secure the signature of a responsible party as indorser of the note, wherever that is possible.

COLLECTING FOREIGN ACCOUNTS

Foreign and Domestic Collections.—Practically the same principles and considerations apply to the collection of foreign

accounts as in making domestic collections. A prompt and systematic follow-up of each account is even more essential here, for the tendency of many foreign customers is to delay payment until greatly pressed. Similarly, sellers who employ prompt and efficient collection methods command the respect of many foreign buyers, while those who allow their accounts to drift along are apt to be taken advantage of by his customers.

Statements and Notifications.—As in domestic practice, some exporters send out statements or bills to all of their customers monthly. These serve as reminders that the bills are becoming due and are also used for purposes of verification of the correctness of the amounts involved. Notwithstanding the advantages to which they may be put, monthly statements are not as a rule desirable in foreign trade. They are at best cold and formal and, besides, many foreign customers, being less efficient and systematic in their business dealings, feel insulted at the idea of being reminded in such a formal manner long before the bill is due.

To eliminate all possible friction and at the same time to call the debtor's attention to the fact that the draft will soon be presented to him by the bank for payment, it is advisable to send, instead of a statement, a personal or form letter, requesting a verification of the figures, so as to avoid all complaints at maturity of the draft and to call the customer's attention to the approaching due date. When tactfully written and in the proper tone, such a letter serves to convert what might have been an overdue account into a prompt payment. To be of maximum benefit, the letter must be dispatched so as to reach the recipient two or three weeks before maturity of the draft. This will enable him to make the necessary preparations to honor it.

Collection Cables and Letters.—If the draft is dishonored when presented for payment, immediate action should be taken, lest the customer be led to believe the creditor afraid to protest for various reasons. If the amount involved is considerable, the customer may be addressed by a cable, in which surprise is expressed at his refusal to pay and requesting an explanation. It is not uncommon to express confidence in the customer's willingness to rectify the mistake immediately. If the account is small, a letter of similar contents is substituted for

the cable. As a result of the use of such letters or cables, immediate settlement is secured on many accounts.

At the same time that an explanation for refusing to honor the draft is demanded from the customer, the collecting bank should be instructed as to the action it should take in regard to the draft. The bank may at this point be of invaluable assistance in ascertaining the reason for non-payment. It may also suggest means of enforcing payment.

If payment is not forthcoming and a reply to the cable or first letter is not received within a reasonable time, a second letter somewhat more harsh should be dispatched to the stubborn debtor. In this letter a suggestion of the credit grantor's willingness to grant an extension, if the debtor is temporarily out of funds, may be made. At any rate, he is asked to explain the reasons for his refusal to meet his obligations with the assurance that reasonable cooperation will be extended him in order to bring about a settlement which is mutually satisfactory.

Enforcing Payment.—It is extremely difficult to force payment of foreign accounts by legal means. In the first place, exporters know much less about collection laws of foreign countries than the customers themselves. Hence, in order to display force effectively and make threats, the exporter must be sure that the threat can be fulfilled. Furthermore, collection by legal means is almost impossible in some countries on account of the inadequacy of the laws. Then, too, suits are very expensive.

Nevertheless it would be wise for every export credit manager to familiarize himself with at least two types of laws of the countries in which he is interested: those relating to the collection of accounts, and those dealing with the form of business organizations. In practically every country there is to be found at least one form of business organization which is peculiar to that country, just as the corporate type of business organization is coming to prevail in the United States. Thus, the prevailing form of business organization in France is the société anonyme; in Mexico, the sociedad anonima, abbreviated S. A.; in Cuba, the sociedad en comandita, abbreviated S. en C.; etc.

Knowledge of the particular form of organization of a customer is essential in order to determine a creditor's rights and limitations in enforcing payment. In many countries there is a definite limit placed on the liability on the various members of the firm,

as, for example, in case of the Cuban Sociedad en Comandita, where the liabilities of the general partners must not exceed the amount of their respective investments in the business, whereas the liabilities of the special partners equal all of their outside resources in addition to the sums invested in the business. Obviously, many legal complications will arise out of an attempt to enforce payment by legal means, unless much thought has been given to the exact legal status of the various members of the delinquent firm prior to such action.

Foreign commercial laws are so numerous, bulky, inadequate from the standpoint of protection to the creditor, and changing so frequently that it becomes rather difficult to keep so well informed of the proper steps to be taken in enforcing payment by legal pressure as to cause one to doubt the wisdom of attempts to collect accounts in this manner.

In view of the foregoing, it is advisable to secure a settlement through amicable means by compromising with the debtor, not necessarily as to the amount of the bill but also in regard to terms or the time of payment. Once a willingness on the part of the seller to compromise is evidenced, it is said that in most cases it will result in the payment of the bill and in the retention of the customer's good will and patronage.

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CHAPTER XXII

COLLECTION CORRESPONDENCE

GENERAL PRINCIPLES

Assumptions.—When payment is not forthcoming on the due date, the first assumption to make is that the indebtedness has escaped the customer's attention. He is, therefore, entitled to courteous reminders, in which he is at the same time requested to verify the correctness of the bill. Failing to receive a reply to the reminders, it is natural to assume that the customer is in financial difficulty. Accordingly, he should be sent letters of discussion in which he is requested to point out the reason for the delay in making settlement. He is also impressed with the seriousness of the situation and with the reasons why payment should be made immediately. If no explanation is forthcoming after several attempts to secure one have been made, it is natural to suppose that the customer is unreasonable and unwilling to meet his obligations. At this point friendly relations may be ruptured and the customer made to feel that his obligations must be met, otherwise he should be prepared to suffer the consequences of more drastic measures taken against him.

Tone in Collection Letters.—Within the limits of the above assumptions there is, no doubt, room for the greatest variety of letters. It is important, however, that the sequence of these assumptions should not be reversed. After a customer has been threatened, or his obligation urged, it is too late effectively to assume a friendly attitude and offer assistance. Accordingly, friendly relations should not be broken until all reasonable means of bringing about an amicable settlement have been exhausted.

Collection letters when improperly used can easily result in serious injury to the collecting house. If they are too harsh in tone, many customers will be repelled. It is also much less difficult to secure payment from delinquent debtors by courteous, tactful, and friendly collection letters than by harsh and sharp

ones. Writers of collection letters often produce a sharp effect when they mean to be courteous and mild, because they fail to realize the effect of the expressions they employ, as when they unintentionally use the words "must," "demand," "insist," "require," "be compelled to," "delinquent," etc. This is accentuated by the fact that many customers are only too ready to read into a letter meanings that the writer did not intend. Consequently, every collection correspondent should keep in mind those phrases which always produce a sharp effect, and carefully guard against ambiguous statements or unpleasant implications. Sharp language should be reserved till more courteous methods have failed. This is so because the aim of collection letters, as of the collection system in general, is to accomplish not one but two definite objects. They must bring previous transactions to a satisfactory conclusion and at the same time retain the good will of the customer and pave the way for continued profitable business relations. Good collection letters are not only money-getters but are business-builders as well.

The tone of a collection letter should be dignified and courteous. Undignified language and methods invariably result in lowering the reputation and standing of the creditor in the eyes of the customer. Furthermore, statements which are merely insulting are ineffective because they arouse anger and destroy the value of whatever appeal is made in the letter. Accordingly, correspondents should refrain from the use of statements which in any way imply that the customer deliberately delays remittance or refuses to reply to previous communications or that his credit standing is inferior. Discourteous language when written is far more stinging than the same language spoken. It is much more effective to assume that he intends to pay and to emphasize the desirability of his paying immediately.

Avoid Excuses.—An apologetic or begging tone seldom produces results. To offer excuses for requesting payment of overdue accounts implies that promptness is illogical. Furthermore, excuses often produce a bad effect upon the customer, resulting in a loss of respect for the house. In writing letters to delinquents, no apologies need be made for seeking settlement. There is nothing to beg and nothing for which to apologize. The money is due and should be paid without further delay.

The debtor knows that and excuses simply weaken the creditor's demands and encourage undue procrastination.

It should be understood at the time credit is first granted that the terms agreed upon are to be maintained and that the creditor will follow up any delinquency with regularity and promptness. A creditor need, therefore, ask for no favor from the debtor. It is an obligation which a customer has assumed voluntarily, its payment is necessary in order to obtain further credit from the house, the bill is due for value rendered, and the creditor needs the funds for the conduct of his own business. These are sufficient reasons for demanding payment of an overdue account. They can be effectively stated in the letters and thus provide the correspondent with adequate material for his correspondence that is logical and requires no apologies.

Flexibility.—No set of collection letters will serve for all customers, at least not beyond the point of formal notifications and reminders. Some customers must be coaxed, some cajoled; others require an appeal to self-interest; while still others can be talked into making remittance by playing upon their sense of business fairness. Some letters require "jogging," while others demand "dunning." Some debtors are sensitive and must be handled with the utmost care, while others are negligent and indifferent and will respond only to unusual treatment. Because of this, a correspondent, before commencing to write any of the personal appeal letters, should carefully study his debtors individually. Good collection letters are original, and carry with them a living and personal message. Writing a letter merely as a communication, without thinking of the objective, will defeat its very purpose. To be successful and accomplish the object intended, the letter must establish a point of contact with the recipient.

To accomplish this end, a correspondent should have before him a complete record of the case, showing the history and development of the account and the number and kind of collection efforts that have already been made. He should at this time recall his impressions of the customer when met personally on a previous occasion, and should also gather all possible information concerning his characteristics and idiosyncrasies through the salesman who had the opportunity of knowing and meeting him on the ground. All this information will safeguard him from making serious mistakes in the treatment he accords the

delinquent debtor in the collection letter that he writes. With all facts before him, he can definitely decide upon the choice of the appeal to be used and the degree of persuasiveness and diplomacy that should be injected.

Personality.—Every collection letter of the personal appeal type should express the personality of the writer, if it is to establish a point of contact. A common defect of many letters is that they lack the grip of personality. Consequently, they do not sound natural nor anything like the spoken language used by the correspondent. Unfortunately, too many letter writers indulge in expressions not characteristic of them and which they would not use when the debtor is personally before them. Instead, they should make letters personal, write in such a tone as befits a man of responsibility and conservative character, and avoid, wherever possible, stilted or conventional phrases or long, involved sentences.

Component Elements.—In every collection system, of which collection letters naturally form an important part and to which they necessarily must conform, there are at least three variable elements. The first deals with the time taken for the complete operation of the system, as well as the time that is allowed to elapse between any two steps in the series of collection efforts. The second element deals with the number of notices and letters to be sent and other steps to be taken. The third element has to do with the kind of appeals and nature of consideration and treatment to be accorded various classes of delinquents.

Obviously, all three are interdependent, each one varying in accordance with the nature of the other elements. The time allowed to elapse between any two notices or letters to be forwarded, for example, varies directly with the nature of the risk. Not only is the interval between any two efforts shorter when collecting from the poor risk, but the time taken for the complete operation of the system until the climax is reached is correspondingly brief. Again, fewer notices or letters are generally sent to the poor risks than to otherwise prompt-paying customers.

Stages in Collection Correspondence.—It is not intended to convey the impression that every account in the collection process necessarily passes through the various stages to be presently discussed. The particular circumstances of a given account may, for example, justify a prompt transition from the

first to the last stage without reminding the customer of his delinquency or without any discussion concerning his reason for the delay in making settlement. Due recognition is also given to the importance of handling each individual case on its own merits. Nevertheless, there are certain well-defined stages through which accounts most frequently pass in the collection process. They are as follows:

1. Stage of Notification.—The customer is notified first that the account is becoming due, and, second, that the bill is already due. The first step is accomplished by a statement sent with the invoice at the time of shipment. It also at the same time serves the purpose of verifying the amount as to the correctness and forestalls possibilities for mistakes, misunderstandings, or excuses. The second step is accomplished by sending another statement timed to arrive the day the account becomes due.

2. Stage of Reminder.—This begins with the date the account matures, when it automatically becomes a "collection." During this stage of the collection process the matter is brought to the debtor's attention by means of additional statements accompanied by brief notices, stamped, mimeographed, printed, or typewritten; also by one or more short and impersonal letters which courteously refer him to the overdue account, which is usually attributed to neglect or oversight.

3. Stage of Discussion.—In this stage, personal collection letters are employed, in which the appeals are graded in strength and in the tone of insistency. The creditor here labors under the assumption that the delinquent debtor has good reason for the delay in settlement, or is in difficulties. Accordingly, attempts are made at this point to secure a response explaining the reasons for the delay. The customer's confidence is invited and the house may either offer to allow additional time or else become more insistent and proceed to the next and last stage of the collection process.

4. Stage of Urgency and Compulsion.—Here the creditor forcibly points out the customer's obligation and the consequences that might result from continued delinquency. It is at this point that a draft is employed as a means of enforcing payment. It is then followed by a letter threatening to place the account in the hands of an attorney or a collection agency,

by whom actual suit may be brought against the debtor should they fail in their efforts to effect an amicable settlement.

TYPES OF COLLECTION LETTERS

All through the stages previously outlined, three distinct types of collection letters are resorted to, each of which has its peculiar characteristics designed to produce the proper effect on the recipient. They consist of formal reminders, personal appeal letters and letters threatening suit.

Formal Reminders.—The principal aim of these collection efforts is to remind the debtor that his account is overdue. As a whole, they are mild and inoffensive. With many delinquents, formal reminders are all that are needed to bring a settlement.

Formal reminders have the following characteristics: they are short, impersonal in tone, stereotyped in language, and courteously refer the customer to the overdue account. In this way the recipient is made to realize that he is not being "dunned," but is simply reminded of his obligation formally and as a matter of customary routine in a manner not unlike the even less distinctive and impersonal typewritten statement.

Types of Reminders.—Formal reminders may take one of four forms. They may consist of a mere statement varying in length, such as "reminder," "Past due; please remit" or "The above account is past due, which fact has no doubt escaped your attention. A prompt remittance will be appreciated." A reminder containing such words may be stamped on the statement which it accompanies by means of a rubber stamp, or attached to it in printed form.

The second type is a more elaborate printed form which accompanies the statement. It is frequently printed on a card, which is then clipped to the statement. It may read somewhat as follows: "The ———— company respectfully calls attention to the accompanying (or inclosed) statement, which, no doubt, has escaped your attention (or has been overlooked)."

The third type consists of a printed or lithographed form with no introductory address or complimentary close, containing blank spaces for the insertion of the name and address of the customer, the amount owed, and the period in which the purchases were made. It is an obvious form and is intended to make an impersonal impression. The blank spaces are filled in with ink or on the typewriter. This form may also be printed on

a card. Its probable contents are: "We beg to call attention to your account of ——— amounting to $———. Your prompt attention will be appreciated"; or "We wish to call attention to your account for ——— (month, etc.), amounting to $———. We trust it will have your immediate attention."

The fourth style of impersonal reminders consists of a series of typewritten or multigraphed forms of letters with blank spaces in which all necessary information may be inserted. These letters are, as a rule, carefully watched and personally signed, and contain a salutation and complimentary close. Where this style of letter is employed, the first reminder is very courteous and mild, excluding all sharp phrases. It is based on the assumption that the debtor has overlooked the account, and all blame for possible mistakes are taken by the creditor. Following are illustrations of the first formal reminder of this type:

Dear Sir:

We are sending you a copy of your invoice of ..... amounting to $....., in order that we may have your check as to its correctness. Our books show the amount as unpaid.

If there is any error please let us know, and we will gladly correct it.

Respectfully yours,

Dear Sir:

Your attention is called to your account of $..... for the month (invoice) of ....., which is now past due. A prompt remittance will be appreciated.

Respectfully yours,

Should this secure no response, one or more formal reminders, the exact number of which will depend upon considerations mentioned in the earlier part of the present chapter, are sent to the delinquent debtor at intervals determined by the timing and dating plan of the collection system of the house. Although courteous assumptions are still proper, these reminders are made somewhat stronger in tone by the inclusion of a sharp phrase, making the request for payment more definite and insistent. Following are illustrations of such reminders:

Dear Sir:

Your invoice of ..... for $..... has now been past due for two months and is still unpaid. We wrote you regarding this matter on ..... but have received no reply. We desire to call your attention again to the need for settlement.

If there is any error or misunderstanding, we hope that you will let us know immediately,

Respectfully yours,

Dear Sir:

We wish again to call your attention to your past-due account of ..... for $....., a detailed statement of which we have previously mailed to you. We shall appreciate receiving a remittance in settlement of this amount by return mail.

Respectfully yours,

In order unmistakably to impress the debtor that all of these reminders are mere forms and do not apply to him alone, some concerns avoid the use of the word "we" by substituting for it the name of the company. The word "you" is frequently omitted for similar reasons by substituting for it "our customers."

To accentuate still further the formal and impersonal character of reminders, stilted and conventional phrases are resorted to. In fact, it is advisable to eliminate all personality and originality in language and use instead expressions that are hackneyed. Only in this manner is it possible to collect overdue accounts without giving offense to customers who are very sensitive about collection matters. To be sure, the appeal made by formal reminders is rather weak on account of their formality, but that may be all that is needed in the majority of cases, and where customers are more stubborn these are essential preliminaries preparing them for more drastic measures.

Personal Collection Letters.—These letters begin with the most important stage in the collection process, the stage of discussion. Personal letters are written only after reminders have been used unsuccessfully as long as the creditor saw fit. To secure the best results, each succeeding letter must lead gradually to a climax. Accordingly, it is necessary that their tone and the appeals they make be definitely graded in strength and insistency. As a result of such a course, many delinquent debtors will be moved to action before the stronger and more insistent and, consequently, offensive communications are employed, whereas, if the stronger appeal were made in the first of the series of personal letters, many customers would, no doubt, pay immediately but would at the same time withdraw their patronage. On the other hand, the more stubborn customers who were not affected by the strong appeal will become callous and uninfluenced by subsequent and weaker communications.

In order to make the first of the personal letters as mild as

possible, a short sales talk is oftentimes included. Not only is the collection impression made less sharp than if it were sent alone, but the sales material also suggests the value of continuing business relations with the creditor by maintaining with it a good standing. The sales material may consist of a sentence to the effect that an early order is expected, or it may involve an entire paragraph calling the recipient's attention to a special sale or some regular or seasonal offering. Sales matter should always come at the end of the letter, for it generally provides a pleasant conclusion.

Since at this stage in the collection process accounts call for personal and individual treatment, it becomes essential that a correspondent, before starting to write any of them, familiarize himself with the actual condition of the account, the personal characteristics of the debtor, and so on. Only after such knowledge has been gained can he proceed intelligently to select the appeal and determine upon the general tone of the letter. Furthermore, it is necessary that these letters possess the grip of personality; that they become personal messages. Consequently, stilted, ordinary, hackneyed, and uninteresting sentences should be avoided, particularly at the beginning. This is because it is but natural for people to dislike to read "duns." If the beginning is sufficiently interesting, personal, and original, however, it will grip the attention of the reader so that he will read the whole message.

Following the beginning or opening statement there comes the main body of the letter, wherein attempts are made, by proper appeals, to make the debtor feel that he ought to make remittance. Once this stage has been reached it is necessary to stimulate him to such an extent as to secure immediate attention. This is accomplished by the ending or conclusion of the letter, which is, of course, varied in strength and insistency in accordance with the position of the letter in the entire series. The more advanced the letter is in the collection series, the more sting the ending contains, and *vice versa.*

Collection Letter Appeals.—The five appeals most commonly employed in collecting accounts are, in the order of strength, sympathy, pride, justice, self-interest, and fear.

Appeal to Sympathy.—The purpose of the appeal to sympathy is to make the customer feel that the concern which has favored him with credit extensions is now suffering financially on

account of his delinquency. It is no doubt the weakest and at the same time the most misused of the appeals. If the organization using this appeal is large, the average debtor believes that the reason given is fictitious and that it does not sound plausible, thus involving a loss of dignity. When the organization is small, however, the debtor is flattered by his financial superiority and will make payment.

The appeal to sympathy may also be used successfully in the first or second of the personal letters, by calling attention to the fact that, although this particular customer's account is small, the sum owed by the several thousands of such accounts which the house carries is considerable. A credit manager may also employ this appeal by explaining that he desires or is asked by his superiors to collect the overdue accounts and make a respectable showing. A letter illustrating some of these points follows:

Dear Sir:

Your check for $..... to cover the invoice of ..... has not yet been received. Your failure to meet this obligation has been probably caused by an oversight.

Although in itself the amount is insignificant, nevertheless the total owed by several thousand similar accounts amounts to a considerable sum. We are quite certain that our customers will realize the hardship that is worked upon us when we are forced to bring the matter constantly to their attention.

If you will, therefore, let us have your check promptly to cover, we shall consider it an accommodation to us.

Very truly yours,

Appeal to Pride.—Pride is one of the strongest emotions and, therefore, one of the strongest incentives to action. When skilfully used, it is almost certain to produce satisfactory results. The following is an example of an appeal to the customer's pride:

Dear Sir:

As you have been in the past most punctual in the matter of payments, we feel that we may rely upon you now to maintain your usual standard. Prompt remittances help us to give the very best service to our customers.

If you will, therefore, let us have your check to cover your account of ..... amounting to $....., you will be helping us materially to this worth-while end. We are counting on your cooperation.

Sincerely yours,

Appeal to Justice.—This appeal has for its purpose to make the customer feel that he is not dealing with the house fairly. In these letters it is usually pointed out that the bill is due

for value rendered, that the creditor has carried the account long after it became due, and that it is not fair and just to compel it to wait any longer for payment. Following is an example of a letter appealing to the sense of justice:

Dear Sir:

We confidently expected a remittance on your account of ..... for $....., as a response to our communication of .....

Obviously, we were disappointed, but it is quite impossible for us to believe that you would intentionally impose.

It has been our pleasure to have the opportunity of rendering you a service. However, there is a sense of reciprocity that should manifest itself in the nature of a remittance.

May we not, therefore, ask that this account be settled now? The return envelope is for your convenience.

Very truly yours,

Appeal to Self-interest.—The letter containing this appeal is stronger and more insistent in tone than any of the letters previously discussed. Logic and argument become more effective. The customer can be shown that it is to his own interest to pay his overdue bills immediately, that prompt payment improves his credit standing and enables the house to sell at reduced prices. Letter illustrating appeal to self-interest follows:

Dear Sir:

On referring to your account with us we find that we are still without a remittance in settlement of the invoice of ....., amounting to $..... The matter has been called to your attention on several occasions, but for some reason we have heard nothing from you in this connection.

Obviously, we are disappointed. When you came to us we placed confidence in you, but unfortunately you have not done your share toward upholding it. It is unnecessary to point out that only by meeting its just obligations can a firm maintain its credit standing in the eyes of the business community.

You surely cannot afford to lose the good will of our house. It must be worth something to you, as it is worth something to all of our customers, whether their purchases are large or small. We therefore hope that you will enable us to continue the confidence we placed in you and that you will do your part toward maintaining cordial relations with us.

Please favor us with your remittance by return mail for the above amount and we shall promptly dismiss the incident from our memory and start anew.

Very truly yours,

Another way in which an appeal to self-interest may be made effectively is that employed by a large number of retailers, who are members of some retail merchants' association. In a letter which they forward to the delinquent, it is explained that the

members are required to report periodically all delinquents, but it is felt that the debtor should be given an opportunity to protect himself against any possible embarrassment that might result therefrom by making settlement on or before a specified date. Needless to say, any resort to threats or expedients of this sort must be used with great caution, because in some states such letters may render the creditor liable to punishment. Even where permitted by law, the plan has the disadvantage of implying a process of blacklisting, which is, on the whole, a bad and undesirable practice, although it may under these circumstances be fully justifiable. Following is an example of a letter of the type under consideration:

Dear Sir:

We have sent you several notices and letters regarding your much past-due account of ..... amounting to $....., but we have not received a settlement from you.

We belong to the ..... Credit Association and are obligated to give them a list of all delinquent accounts. We are now making up this list and will wait ..... days to hear from you.

Please remit at once and save us both the unpleasantness of reporting your account.

Very truly yours,

Part Payment.—At this point it may be advisable, as a precaution, to send what is generally known as a letter of courtesy, in which the customer is given one more opportunity to explain his neglect to make payment. When this fails to secure a response, an attempt may be made to secure part payment and arrange for other payments at definite intervals. A suggestion to this effect rarely fails to bring a reply, since it is plausible and appeals to the debtor. This method is usually resorted to by wholesalers and manufacturers where the accounts carried involve relatively large amounts. In such instances a real service is rendered the debtor who is unable to accumulate an amount large enough to pay his bills in their entirety.

Dear Sir:

On ..... (date) we wrote you in regard to your past-due account, amounting to $....., but we do not seem to have received a remittance to cover in compliance with our request, nor any explanation of the delay in settlement.

You will agree with us that we have been exceedingly lenient in the matter, but must regret our inability to advance the matter further without a remittance of at least $..... to reach us by ..... It will then be satisfactory if the balance is settled within (.....).

Yours truly,

Use of Drafts.—One of the more urgent steps taken at this point, particularly by wholesalers and manufacturers, is the sending of a draft. The purpose of this step, and its advantages, have already been treated in the preceding chapter. The letter announcing the sending of a draft consists of a simple statement reviewing the action already taken and stating that unless a response is made within a certain time a draft will be dispatched to the debtor's bank, or it may be a long and sharp letter emphasizing the seriousness involved in dishonoring the draft.

Dear Sir:

Since we have not heard from you in response to our letters of ..... and ..... concerning the amount of $..... due on ....., we find ourselves unable to advance the matter further. We must now insist upon the settlement of your past-due account.

Failure to hear from you by ..... will force us to place a draft on you with our bankers to cover the above amount. We ask that you arrange to take care of this upon presentation. If you wish to head off the sending of the draft, please favor us with your check by return mail.

Very truly yours,

Appeal to Fear.—If the draft has been dishonored and all of the personal appeal letters have failed to secure a response or payment of the obligation, the creditor may send a personal collector, or the credit manager himself may call upon the debtor under certain circumstances. If none of these are feasible, threat letters are resorted to. They make an appeal to fear and are the harshest of all collection letters. The debtor is usually threatened that he will be sued immediately, unless payment is forthcoming on or before a specified date or that the account will be placed in the hands of an attorney or a collection agency. Its purpose is to point out the disagreeable consequences that will result from further delay and that the debtor cannot escape payment of his just obligations. It is, therefore, desirable to write a rather lengthy letter in which the seriousness of the matter may be dwelt upon sufficiently. It is sometimes advisable to use sharp language with a veiled threat to take drastic measures in the hope of moving the delinquent into action; and if this fails to bring a response, the threat is made openly and at length as pointed out above. Examples follow:

Dear Sir:

Despite the fact that we have sent you numerous notices and letters regarding your past-due bill of $..... for ....., we have heard nothing from you and we are at a loss to understand the situation. We, therefore, feel that we have waited long and patiently and now urgently request your immediate attention.

We assure you that we have no desire to embarrass or trouble you, but it is necessary that this account be settled at once, and we trust that you will make satisfactory arrangements so that the matter may be adjusted without delay.

Very truly yours,

Dear Sir:

Although the matter has been brought to your attention on several occasions you have neither sent us your check in settlement of your long past-due bill amounting to $..... .. for the month of ..... nor given any reasons for delaying payment. This compels us to consider a step that we very much dislike to take, to place your account in the hands of our attorneys for such action as they find necessary.

While we dislike very much having to write you in this manner and to think that anyone who is a customer of ours would compel us to consider such drastic measures, you must appreciate that we have been very considerate and patient and that there is nothing else left for us to do.

We, therefore, feel constrained to state that unless a remittance of the full amount is received by return mail, we shall give your account to our attorneys.

Respectfully yours,

Where permitted by law, retailers who are members of some merchants' association are furnished with one or two form letters which are supposed to have been sent by the bureau which the association maintains and which read as though coming from the bureau. These letters have been found very effective. They read somewhat as follows:

Dear Mr. .....:

In preparing the files of this bureau, organized for the mutual interchange of credit information, we find that (name of store) reports an account against you which is past due.

We would suggest that you make settlement with your creditor at once so that your record may be clear in our files.

Members of the bureau will, under our rules, report to us within five days as to whether or not settlement has been made.

Very truly yours,

Dear Mr. .....:

We wrote you under date of ....., stating that (name of store) had reported an account against you which is past due.

Our letter showed clearly that it was sent in order to give you an opportunity to make settlement with your creditor in order to avoid an unfavorable credit report with us.

Operated, as our bureau is, by the leading retail merchants of ....., our aim is to conduct negotiations with you in confidence and with utmost fairness. It is our business to give accurate and truthful information as to the paying habit of customers when inquiry is received from members of the bureau, and we feel sure you will appreciate the value of a good credit standing with these merchants.

We shall expect you to make settlement with your creditors at once. Under the rules of our bureau, unless this is done within five days, the matter will be turned over to our attorneys for whatever action they deem necessary.

Very truly yours,

Collecting Interest on Past-due Accounts.—This is one of the more difficult and delicate problems that arise in the collection of past-due accounts, involving a question of business policy. From the standpoint of justice and equity it would seem imperative that interest be charged on all overdue accounts. At time of sale, definite terms are agreed upon by both parties, on the basis of which the seller arrives at the selling price of his product. Thus, the money belongs to the seller from the date on which the terms of sale expire. If the debtor fails to pay the bill at maturity, and refuses at the same time to pay interest for the use of the money, he unjustly appropriates property belonging to the creditor, which he could not do under any other circumstances without rendering himself liable to punishment. In this manner, the debtor commits two wrongs: one by using the creditor's property without the latter's consent; the other, by refusing to compensate him in a manner similar to what would be required of him were he to borrow the funds elsewhere.

Failure to charge interest on overdue accounts not only results in unfairness to the creditor himself, but it also involves unfair discrimination against customers who pay their bills promptly. In order to pay their bills at maturity, prompt-pay customers borrow at the banks and pay interest on the funds thus obtained; whereas the slow-pay debtors, by paying nothing for the funds which they employ and by obtaining the same prices from the seller, secure an undue advantage, inasmuch as the terms of sale to them are actually extended by

the period of slowness. This naturally places a premium upon delinquency, which may well be taken advantage of even by customers who could and would otherwise pay their obligations with great promptness, the corollary of which is that insistence upon the payment of interest on overdue accounts necessarily results in improved collections.

In order to collect interest on all overdue accounts, several methods may be employed. Words to the effect that interest is charged on overdue accounts may be printed on all statements, and actually added to the amount owed. Another way is to attach a printed sticker to all past-due statements, and either add the interest to the amount of the bill or send a separate bill for it. The total amount owed, including the interest item, should thereafter be given in all communications in which attempts are made to collect the account.

SELECTED REFERENCES

Cassell, R. J.: "Constructive Collecting," chaps. 25 and 26.
Gardner, E. H.: "Effective Business Letters," chaps. 10, 11, 12, and 13.
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CHAPTER XXIII

GENERAL RIGHTS AND REMEDIES OF CREDITORS

Under certain circumstances and conditions, unpaid sellers of merchandise may exercise special rights against the goods and resort to certain remedies, even though title to the goods has passed to the purchaser. A seller of merchandise is deemed unpaid, if the whole of the purchase price has not been paid or tendered to him; when a negotiable instrument has been given as a conditional payment in the form of a check, draft, or note, and it has been dishonored; or when the buyer becomes insolvent before the bill is paid.

UNPAID SELLER'S LIEN

Nature of Lien.—A lien constitutes a right of one party to retain in his possession goods belonging to another party until the demands of the holder of the lien have been satisfied. In the case of an unpaid seller's lien, it is implied that the buyer, to whom title to the goods has passed, retains ownership of the merchandise but that the seller or holder of the lien possesses a claim or right, not to ownership, but to hold the goods as security until the obligations of the purchaser have been discharged in accordance with the agreement governing the transaction. Whether or not title to the goods has actually passed depends upon the intention of the parties to the transaction, according to the Uniform Sales Act, which also sets forth certain rules to be observed in determining intent, when it is otherwise difficult to prove.

When Right May Be Exercised.—According to Sections 54 to 56 of the Uniform Sales Act, the right to a seller's lien may be exercised under two distinct circumstances. Where merchandise is sold on a strictly cash basis, *i.e.*, without any agreement involving the extension of credit to the purchaser, the seller may retain possession of the goods until they are paid for, even though the title to the goods passes immediately. The other

possibility for the exercise of a lien is when goods are sold on credit.

In this case the seller may exercise his right of lien when the term of credit has expired before delivery of the goods, or when the buyer becomes insolvent while the goods are still in possession of the seller. This is obviously based on the theory that in extending credit the seller waived his right of lien on the implied condition that the buyer's financial and credit responsibility would remain unimpaired. Upon breach of this implied condition, the seller has the privilege of exercising his right of lien. It is also specifically provided that his right of lien may be exercised even though the seller is "in possession of the goods as agent or bailee for the buyer."

Effect of Part Delivery.—Where the unpaid seller has made part delivery of the goods, he may still exercise his right of lien on the remainder, provided such past delivery has not been made under circumstances showing an intent to waive the lien or right of retention.

When Lien Is Lost.—An unpaid seller loses his lien as soon as he parts with the goods, or as soon as the buyer tenders the purchase price. Section 56 of the Uniform Sales Act specifically provides that the unpaid seller of goods loses his lien thereon (1) when he delivers them to a carrier or other bailee for transmission to the buyer, without reserving to himself the title to the goods, or the right to the possession thereof; (2) when the buyer or his agent lawfully obtains possession of the goods; or (3) when the seller waives the lien. In this connection it should be observed that the unpaid seller does not lose his right of lien by reason of a judgment or decree obtained by him for the purchase price of the goods, for there may be little or nothing on which to levy and the judgment would, therefore, prove worthless. Consequently, it would be bad policy to compel the seller to surrender his merchandise in return for a judgment which may prove worthless.

STOPPAGE IN TRANSIT

When Right May Be Exercised.—The unpaid seller's lien continues in effect only during the time the goods are in his possession. Notwithstanding the fact that he has voluntarily parted with the actual possession of the merchandise, the seller is nevertheless still in a position to avail himself of his right of

lien indirectly by way of exercising his legal right to stop the goods in transit. This may be done only in case of the buyer's insolvency. It frequently happens that a seller who has dispatched goods to a buyer at a distance learns in the meantime of the insolvency of the buyer. Thus, the Uniform Sales Act provides that:

> The unpaid seller who has parted with the possession of the goods has the right of stopping them in transit, that is to say, he may resume possession of the goods at any time while they are in transit, and he will then become entitled to the same rights in regard to the goods as he would have had if he had never parted with their possession.

As already indicated, the right of stoppage in transit rests solely upon the apparent insolvency of the buyer at time of sale or after the sale was made. It is but just and equitable that the goods of the seller shall not be applied to the payment of the debts of the buyer. It is not necessary that the buyer become actually or technically insolvent; so long as the purchaser by the manner in which he conducts his business furnishes usual apparent evidences of insolvency, it is deemed sufficient ground for such action. Thus, failure to meet his bills at maturity, or inability to pay his notes when due thereby causing them to be protested, constitutes evidences of insolvency as required by the act.

When Goods Are in Transit.—According to Section 58 of the Uniform Sales Act, goods are deemed to be in transit from the moment the seller or his agent delivers them to a carrier or other bailee for transmission to the buyer until the time of delivery to the buyer or his agent by such carrier or other middleman. The right of stoppage continues not only when the goods are in actual transit, but until they are delivered into the actual or constructive possession of the buyer or his agent. The unloading of the merchandise or placing it in the warehouse of the carrier or other bailee does not necessarily terminate the period of transit. As long as the goods remain in the hands of the carrier as such, the right of stoppage continues. This observation applies as well to possession of goods by a carrier after rejection on the part of the buyer, even when the seller has refused to receive them back.

The right of stoppage ceases if the buyer, or his agent, obtains possession of the goods before their arrival at the point of desti-

nation. The same condition obtains if, on arrival of the goods at destination, the carrier or other bailee notifies the buyer or his agent that it is in possession of the goods as bailee for the buyer or his agent. The goods are no longer considered in transit after such acknowledgment, even though a further destination has been indicated by the buyer and they still remain in the possession of the carrier or other bailee. Similarly, the goods are no longer in transit after the carrier or other bailee wrongfully refuses to deliver them to the buyer or his agent.

Provisions 3 and 4 of Section 58 are the other conditions under which goods are to be construed as being in transit. They are as follows:

> (3) If goods are delivered to a ship chartered by the buyer, it is a question depending on the circumstances of the particular case, whether they are in possession of the master as a carrier or as agent of the buyer.
>
> (4) If part delivery of the goods has been made to the buyer or his agent, the remainder of the goods may be stopped in transit, unless such part delivery has been made under such circumstances as to show an agreement with the buyer to give up possession of the whole of the goods.

In the event the goods, while subject to the unpaid seller's right of lien or stoppage in transit, are sold or otherwise disposed of to a third party, the seller is not affected by such action, unless he has assented thereto, or unless the transaction has been consummated by way of transfer by buyer of a negotiable document which was delivered to him by the unpaid seller. Thus, the right of stoppage is defeated if a bill of lading in negotiable form has been transferred by the first purchaser to a second *bona fide* purchaser for value. The principle underlying such law is that it is more equitable to limit the right of stoppage in transit of a seller who has entrusted the buyer with a perfect title than to deprive an innocent purchaser for value to whom such title has been negotiated.

Procedure in Exercising the Right.—It is not essential that a special form be used for the purpose. All that the seller need do is immediately to notify the carrier of his decision to exercise the right of stoppage. Notice may be given to the person in actual possession of the goods, or to his principal. If given to the latter, sufficient time is required to enable the principal "by the exercise of reasonable diligence" to prevent delivery to the buyer. From the time the carrier receives the notice he is under

obligation not to deliver the goods to the consignee. Instead, they are to be redelivered to the seller or otherwise disposed of according to his instructions. The seller, of course, bears all the expenses incident thereto. Section 59 of the Uniform Sales Act also provides that if a negotiable document of title to the goods has been issued by the carrier, the seller must first surrender it for cancellation before the goods are redelivered to him. If the carrier surrenders the goods to the buyer after being properly notified to stop them, he renders himself liable to the seller in action in tort for conversion of the goods, or for breach of contract, notwithstanding the fact that the right of stoppage is not an expressed but implied condition of the contract with the carrier to deliver.

Effect of Stoppage in Transit.—The mere fact that the seller chose to exercise the right does not necessarily involve a rescission of the original sale. The buyer may still claim and exercise his right of possession by paying or tendering the purchase price of the goods. Otherwise, the effect is merely to restore the goods to the possession of the seller, who may then choose to sue for damages sustained through the buyer's non-performance of the contract. On the other hand, if the goods were stopped in transit when the seller had no reasonable grounds for doubting the buyer's solvency, the buyer may not only compel delivery but may also sue the seller for any damage caused because of the delay in delivery and failure to comply with the terms of the contract.

RIGHT OF RESALE

Significance.—It should be remembered at this point that title to the goods is still vested in the buyer even after the goods have been recovered and reduced to possession through the exercise of the right to stop them in transit. If the buyer does not tender the purchase price and claim the goods within a reasonable time, however, the seller may resell them to a third party, who thereby obtains a valid title thereto. Technically, the seller acts in the capacity of agent for the buyer, and makes the resale merely for the purchase price. In spite of this, the original buyer never receives a profit, if such is made, on the resale, to which he should be technically entitled.

Time and Manner of Resale.—Section 60 of the Uniform Sales Act provides that an unpaid seller who has a right of lien,

or who has stopped the goods in transit, may resell the goods under any of the following conditions:

1. If the goods are of a perishable nature.
2. If a right of resale has been expressly reserved upon default of the buyer.
3. Where default in payment of the purchase price has existed for an unreasonable length of time.

Such resale may be either public or private, provided the seller exercises reasonable care in making it. The validity of the sale is not in any way affected by failure to give notice of intention to the original buyer, except where the goods are resold because of default in payment of the purchase price for an unreasonable length of time, in which case the matter may be disputed, as to whether the buyer had been in default an unreasonable time before the resale was made. As a matter of precaution, it is advisable, though not essential, that such notice should be given in all cases except where the goods are of a perishable nature.

RIGHT OF RESCISSION

Time and Manner.—A seller who has not parted with his goods or who has recovered his lien through the exercise of his right of stoppage in transit is permitted to rescind the transfer of title and resume ownership of the goods, when:

1. The right of rescission has been expressly reserved in the contract to the seller.
2. The buyer has been in default an unreasonable length of time.
3. The buyer has repudiated the sale.

Upon rescission, the seller revests himself with the title to the goods, and, in case of a resale, he need not account for any profits gained, but is entitled to damages sustained as a result of the default of the buyer.

Notice of the rescission and a retransfer of title should be given to the buyer as a condition precedent to the complete resumption of title, although it is not absolutely essential. All that Section 61 of the Uniform Sales Act provides is that the intention to rescind a sale be evidenced by notice of some overt act. Such act need not be communicated to the buyer, but as a matter of precaution it should always be given, for the giving or failure to give notice becomes relevant in an issue involving

a determination of whether the buyer has been in default an unreasonable length of time before the right of rescission was exercised.

REPLEVIN

Nature and Purpose.—In certain cases the seller of merchandise, in addition to his right of action for damages, is given the right to retake or recover his property. Technically speaking, he may exercise his "right of replevin or recaption." The granting of this right is based on the same principle which underlies the legal right of stoppage in transit. Thus, where the purchaser has been guilty of fraud or misrepresentation, the prospects of collecting the purchase price are very remote. Consequently, the seller may exercise his right of replevin. Even though the seller voluntarily delivers the goods to the fraudulent buyer, directly or through an agent, the latter is guilty of wrongfully taking the property, and the seller is justified, under such circumstances, in rescinding or avoiding the sale, and thereby insisting that no title or right of possession ever passed to the buyer. He may then recover the goods, provided he offers sufficient security against any injustice the buyer may suffer in consequence of such action. Although originally it was necessary to prove, in addition to the wrongful possession of the goods, that the buyer had come into possession unlawfully, it is no longer true in most states. Even where a buyer is not guilty of a wrongful taking or seizure, the seller will be allowed to exercise his right of replevin on goods wrongfully detained by a fraudulent purchaser.

Procedure.—To exercise the right of replevin, the seller applies in the proper court for a writ of replevin; if granted, the writ authorizes and directs the sheriff, or any other officer of the court, to summon the fraudulent buyer to appear before the court to answer the action of the plaintiff for wrongfully detaining the goods and chattels described therein, and to seize the said property and keep it in his possession till further order of the court. The present possessor, namely, the person from whom the property has thus been taken, has the privilege of bonding back the goods. For this he is to furnish security so that the rightful owner, should it be decided that he is not rightfully in possession of the goods, will be protected against any loss pending a decision of the court.

As a prerequisite to the service of a writ of replevin, the seller is required to furnish a bond of indemnity, which is usually twice the value of the property involved, with sureties as security to the purchaser against any injustice that he may suffer as a result of wrongfully suing out of the writ.

When Right of Replevin Is Lost.—The owner of property wrongfully taken or acquired from his possession may exercise his right of replevin as long as the goods may be identified. He may follow them and reclaim them, even where their form has been changed, unless they have been annexed to another commodity in such manner as to become part of it. In like manner may the seller pursue any proceeds of the goods received by the defendant as long as they can be identified. Thus, a purchaser from the defendant, who buys with notice of the litigation in an action of replevin pending, buys at his risk. If judgment is subsequently rendered against the defendant, the property will be taken from such purchaser regardless of whatever sum he may have paid for it. Again, if a portion of the property has been destroyed, concealed, or sold by the defendant, the seller may replevin such portion as can be found and identified, and maintain a separate action to recover the value of the remainder. The right of replevin may be exercised not only against goods, but also against choses in action, such as checks, promissory notes, bonds, and the like.

If the goods or the proceeds received from their sale cannot be identified because they have been so intermingled with other goods of the same character and proceeds, the right to reclaim them is lost. Similarly, when the goods or proceeds fall into the hands of a third party who is a *bona fide* holder for full value, and without knowledge of the original purchaser's fraud, the first seller loses the right to reclaim the property in specie. Instead, he sues the defendant for the value of the property at the time replevin is attempted plus damages for the injury suffered. If the original purchaser or defendant obtained possession of the goods by fraudulently impersonating another or fraudulently pretending to be the agent of another, it is held that no sale took place, and, hence, no title was ever passed to the fraudulent buyer. He, therefore, could not pass any title to a third party, regardless of the latter's innocence or value paid for the property. Since the original owner of the goods never intended to sell to the defendant, the latter acquired no

title, and any one who later purchased the goods from the defendant acquired no better title. The original owner is entitled, therefore, to pursue the goods and regain possession.

A seller may also lose his right of replevin by waiver. Thus, where a seller, having full knowledge of the fraud committed, accepts payment, a note, or security, or when he brings suit for the purchase price of the goods, he thereby loses his right to reclaim the goods in specie, for his action constitutes an affirmation of the contract of sale and a waiver of his right of replevin. The seller is not estopped from recovering his goods if any of these actions are taken without any knowledge of the fraud that has been committed. Neither is this right affected by subsequent bankruptcy of the defendant.

ATTACHMENT

Nature and Purpose.—Attachment has been defined as a legal proceeding whereby a lien on property of the debtor is secured for the benefit and protection of creditors.[1] It is a provisional remedy whereby the defendant's property is seized and taken out of his control and held for the payment of a debt on which suit has been or is about to be brought by a creditor. If an attachment has been made prior to bringing suit, such action must be taken within a certain time, usually 30 days, after service of the writ of attachment; or else jurisdiction over the property attached ceases.

The purpose of this provisional remedy is to prevent a debtor from so disposing of his property during the pendency of a suit against him as to place it beyond the reach of his creditor in case he is successful in his action. It is a precautionary measure much appreciated by creditors who have learned from experience that debtors with ample assets cause them to disappear or make them execution proof after a judgment has been obtained.

Grounds for Attachment.—The right of attachment is purely statutory, the statutes usually specifying in great detail the classes of action in which the writ may be issued and the peculiar circumstances and relationships which must exist in these actions before the writ may be issued. Attachment proceedings are highly technical in most states, and if these technical re-

[1] Brewster, S. F., "Legal Aspects of Credit," p. 316.

quirements are not strictly complied with, the defendant may cause the attachment to be vacated.

Although the statutes differ widely in certain particulars, yet the principal grounds for resorting to this remedy are substantially the same in practically all states. They are as follows:

1. That the debtor is a non-resident of the state where the writ of attachment is sought against the debtor's property located within the state. This is one of the most usual grounds for granting an attachment. Thus, for example, in most jurisdictions it is sufficient if the defendant is a foreign corporation.

2. That the debtor has departed from the state with intent to defraud creditors or to avoid service of legal process.

3. That the debtor keeps himself concealed with intent to defraud creditors or to avoid service of legal process.

4. That the debtor has removed property or is about to dispose of property for the purpose of defrauding his creditors.

5. That the debtor has secured property from the creditor by fraudulent representations, such as the making of a false statement in writing regarding his financial condition.

In some states there are additional grounds for using this extraordinary remedy. Thus, for example, the grounds for attachment in the state of Ohio are as follows:

1. Non-residence of defendant or where the defendant is a foreign corporation.

2. Defendant is a corporation whose chief office is outside of the state.

3. Defendant absconded.

4. Defendant hides or conceals himself with intent to avoid services of legal process.

5. Defendant left county of his residence to avoid service of legal process.

6. Defendant fraudulently withholds money and property liable to satisfy debts.

7. Debtor fraudulently concealed or removed his property.

8. Debtor is about to remove, conceal, assign, or dispose of his property fraudulently to delay creditors.

9. Debtor is about to remove his property from the state.

10. Debtor converted or is about to convert his property into cash with intent to place it beyond the reach of creditors.

11. Where debt was fraudulently contracted.

12. Defendant refused to pay price of article or thing delivered to him which was payable when delivered.

13. Refused to pay value of work performed or services rendered at defendant's request.

Attachment Procedure.—Prior to the issuance of a writ of attachment, the plaintiff or creditor is required in most states to make an affidavit stating the amount of the indebtedness; that the claim is just; that no part of the debt claimed has been paid; the manner in which the debt accrued; that he is not indebted to the defendant; that the sum demanded is actually due; and the ground or grounds for attachment. The affidavit may be made by the creditor himself, his agent, or attorney. Another condition precedent to the issue of the writ of attachment in practically all states is the requirement that the plaintiff give a bond, or undertaking, with sufficient sureties, to protect the debtor against any injury which would result from a wrongful attachment, as where the debtor recovers judgment, or causes the attachment to be vacated. The attachment is not to be construed as wrongful, if the plaintiff had good cause to believe the grounds for attachment true, although cases to the contrary may be found in some states.

As soon as the writ of attachment is issued, the sheriff to whom it is directed immediately proceeds to execute it, by attaching enough property, which is not exempt from levy, to satisfy the creditor's claim, together with costs and expenses. If the original levy is insufficient, additional levies may be made from time to time until a sufficient amount of property has been attached. On the day specified in the writ, the sheriff returns a report of the procedure together with an exact and specific description of the property attached. The attachment then constitutes a lien on the debtor's property dating from the date of the actual execution of the writ. This lien is afterwards made absolute by judgment. In this connection it should be observed that in most states an attachment may be dissolved by the defendant tendering a bond for the payment of whatever judgment may be rendered against him.

SUPPLEMENTARY PROCEEDINGS

Nature and Purpose.—It frequently happens that, during the pendency of a suit against him, the debtor may transfer his assets so as to make them judgment proof. One of the pro-

visional remedies is to obtain a writ of attachment. It may be difficult, however, to prove sufficient grounds for the issuance of such a writ. Where attachment is not resorted to, or where insufficient property has been attached, a judgment creditor is given the right to examine the debtor under oath in proceedings supplementary to the judgment obtained with a view to determining the manner in which the assets were transferred to a third party and the disposition of the proceeds in case of sale. Any or all persons indebted to the judgment debtor may also be examined in supplementary proceedings. All assets so discovered may then be applied to the satisfaction of the judgment, subject to certain exemptions specified in the statute under consideration. Obviously, a condition precedent to supplementary proceedings is the securing of a judgment which has been returned unsatisfied after execution. Such right may be exercised any time within the period provided by the statute in question.

GARNISHMENT

Nature and Purpose.—Where property has been transferred with a view to defrauding creditors, a creditor may, in many jurisdictions, exercise the right of garnishment, and hold the transferee liable as trustee to account for the property thus transferred or the proceeds from its sale. Garnishment, sometimes termed "trustee process" or "third party proceedings," is a process resembling that of attachment, whereby the creditor acquires a lien or right to hold the garnishee, in whose possession the goods, money, or credits of the debtor are found, personally liable for his debt to the defendant. A garnishee is supposedly an innocent third party owing money to the defendant or in whose possession property of the defendant is found without his fault or blame. When this property or debt is attached, the garnishee is regarded in the eyes of the law as a trustee or custodian of the property or debt and is restrained from paying the debt or returning the property to the defendant. The purpose, then, of the right of garnishment is to give notice or warn the garnishee to the effect that he is not to settle with the defendant but to answer to the suit of the creditor. Garnishment applies to all cases where a third party has in his possession any property or funds belonging to the debtor. In some jurisdictions, as in the state of Ohio, for ex-

ample, a notice may be issued to the garnishee, who is the employer of the defendant, to withhold 10 per cent of his personal earnings due and to become due from the date the notice is issued until "the final trial and adjustment of the cause for which the action is brought."

THE BULK SALES LAW

Purpose and Value.—Prior to the enactment of Bulk Sales Laws in the various states, it was not uncommon for dishonest debtors to sell their entire stock in bulk quickly and at a ridiculously low valuation, with intent to defraud their creditors. A practice somewhat similar to selling out to a third and *bona fide* purchaser for value would be one where the goods in bulk are transferred by a single proprietor or partnership to a corporation, into which the business was previously incorporated, in exchange for capital stock. To prevent such sales and transfers being consummated to the detriment of creditors, Bulk Sales Statutes in substantially similar form have been enacted by every state and the District of Columbia, due largely to the sponsorship of the National Association of Credit Men.

The purpose of the Law is to suppress the widespread evil and practice of dishonest debtors from selling their goods in bulk secretly for the purpose of defrauding their creditors; for the most important uniform requirement of these laws is that the purchaser of goods in bulk must notify the creditors of the seller that the sale is to be made, otherwise the sale becomes void in some states, and, presumptively fraudulent and voidable in others, even though the word "void" is used. The word "void" in these statutes is frequently interpreted to mean merely "voidable," as in Illinois, for example.

Example of Bulk Sales Laws.—Notwithstanding certain minor differences in the statutes of the various states respecting formal requirements, the substance of all of these laws is practically the same. The Bulk Sales Law of Ohio, approved May 5, 1913, which is identical in every respect with that enacted by the state of New York and others, is herewith reproduced to illustrate the nature of the general contents of such statutes. It provides in Sections 11102, 11103 and 11103–1 of the General Code, respectively, that:

> The sale, transfer or assignment, in bulk, of any part or the whole of a stock of merchandise, or merchandise and fixtures pertaining to

the conducting of said business, otherwise than in the ordinary course of trade and in the regular and usual prosecution of the business of the seller, transferrer or assignor, shall be void as against the creditors of the seller, transferrer, assignor, unless the purchaser, transferee or assignee demands and receives from the seller, transferrer or assignor a written list of names and addresses of the creditors of the seller, transferrer or assignor, with the amount of the indebtedness due or owing to each and certified by the seller, transferrer and assignor, under oath, to be a full, accurate and complete list of his creditors, and of his indebtedness; and unless the purchaser, transferee or assignee, shall at least (5) five days before taking possession of such merchandise or merchandise and fixtures, or paying therefor, notify personally, or by registered mail, every creditor whose name and address appears in said list, or of which he has knowledge, of the proposed sale, of the price, terms and conditions thereof.

Sellers, transferrers, and assignors, purchasers, transferees and assignees, under this act shall include corporations, associations, co-partnerships and individuals, but nothing contained in this act shall apply to sales by executors, administrators, guardians, receivers, trustees in bankruptcy or by any public officer under judicial process.

Any purchaser, transferee or assignee, who shall not conform to the provisions of this act, shall at any time within ninety days after such sale upon application of any of the creditors of the seller, transferrer or assignor, become a trustee and be held accountable to such creditors, for all the goods, wares, merchandise and fixtures that have come into his possession by virtue of such sale, transfer or assignment, provided, however, that any purchaser, transferee or assignee, who shall conform to the provisions of this act shall not in any way be held accountable to any creditor of the seller, transferrer or assignor, or to the seller, transferrer or assignor, for any of the goods, wares, merchandise or fixtures that have come into the possession of said purchaser, transferee or assignee by virtue of such sale, transfer or assignment.

Thus it follows that in states where sales in bulk are declared absolutely void for non-conformity with the statutes, that if proper notice has been given by the purchaser under the Bulk Sales Statute and possession of the stock has not been taken within the number of days specified in the statute, the creditors may attach the goods or by any other legal process obtain the assets for the satisfaction of their claims, even though the purchase price has already been paid by the vendee. If possession of the goods has been taken by the vendee prior to the expiration of the specified number of days required for notice, assuming due notice to have been given, the creditors may subject the

money in the hands of the purchaser for the payment of their claims.

If the act has not been complied with by the purchaser or seller, however, creditors may within a specified number of days subsequent to sale apply to the court asking for the appointment of a receiver to take charge of the assets involved, or else request that the vendee be declared a trustee for the benefit of the creditors. Debts are thereupon ascertained and the assets appraised and sold. The proceeds are then distributed among the creditors. In this manner the main obstacle in the prosecution of fraud is completely removed. Under the Bulk Sales Law it is not necessary to substantiate the allegation of fraudulent intent as required under other circumstances, for the burden of proof is placed upon the defendant. All that creditors have to show is that the sale took place without complying with the requirements of the statute.

Validity of Bulk Sales Statutes.—In the state of Ohio, as well as in some of the other states, the Bulk Sales Law was at first declared unconstitutional by the state courts on the grounds that it constituted legislation in restraint of trade, and particularly because it violated the fourteenth amendment to the Federal Constitution, which provides that "no state shall deprive any person of life, liberty or property without due process of law, nor deny to any person within its jurisdiction the equal protection of the laws." Later decisions, however, upheld the constitutionality of the law. Thus, in *Bloomfield vs. State*[2] it was clearly stated that "the state is necessarily invested with that which is called the police power, which will be, and should be, put forth as an expression of the popular conception of the necessities of social and economic conditions. Under it may be done, and should be done, that which will best secure the peace, morals, health and safety of the community." Again, in *Bachtel vs. Wilson*[3] and in *St. John vs. New York*[4] it was held that "the fourteenth amendment was not designed to prevent all exercise of judgment by a state legislature, of what the interests of the State require, nor to compel it to run all of its laws in the channels of general legislation."[5] Similarly, in

[2] 86 Ohio State 264.
[3] 204 U. S. 36.
[4] 201 U. S. 633.
[5] From circular of the National Association of Credit Men.

Frisbie vs. United States[6] it was held that "while it may be conceded that, generally speaking, among the inalienable rights of the citizens is that of the liberty of contract, yet such liberty is not absolute and universal. It is within the undoubted power of the government to restrain some individuals from all contracts, as well as all individuals from some contracts."

In conclusion, some of the comments on the constitutionality of the New York statute, made by Justice Johnson of the Supreme Court, may be given. He said in part that:

> We think it clear that there are substantial reasons for the classification made by this statute. It applies equally to all merchants having a stock of merchandise for sale in the usual course of trade who have creditors. It operates upon such cases when there is contemplated a bulk sale of the stock otherwise than in the ordinary course of trade. It relates to all purchasers. If affects all within the class of creditors of such merchants. The necessary results of its operation would be in the interest of honest merchants and of the public welfare, for these are concerned in the prevention of frauds and in the protection of public morals.[7]

The statutes apply to sales "in bulk" or "the whole or a major part" or "more than half" of a stock of goods, and must be made otherwise than in the ordinary course of trade, as determined by the usual method of disposing of the stock of goods employed by the merchant under consideration. Fixtures are not construed to be a part of the stock of goods within the meaning of the law, but are in most states specifically included.

Classification of States.—In general, the states may be divided into three groups in regard to their laws regulating the sale of goods in bulk, depending upon the effect which nonconformity with the statutory requirements has upon the validity of the sale. In the first group are included the following 16 states:

Arizona	Kansas	New York
Arkansas	Maine	North Dakota
Colorado	Maryland	Ohio
Connecticut	Michigan	Texas
Indiana	Virginia	
Iowa	Nebraska	

[6] 157 U. S. 160.

[7] BREWSTER, S. F., "Legal Aspects of Credit," pp. 362–3; also from circular of the National Association of Credit Men.

In these states the statutes provide that the effect of non-compliance with the statutory requirements renders the sale absolutely void, and the goods are subject to attachment in the hands of the vendee. In the second group are 20 states, including the District of Columbia, in which the effect of non-compliance renders such sale or transfer both void and fraudulent. These states are as follows:

California	Missouri	Rhode Island
District of Columbia	Montana	Utah
Idaho	Nevada	Vermont
Illinois	New Hampshire	Washington
Kentucky	New Mexico	West Virginia
Massachusetts	Oregon	Wisconsin
Mississippi	Pennsylvania	

In the third group are 12 states whose statutes provide that the effect of non-compliance with requirements is to create a presumption that the sale or transfer was fraudulent and void. However, if fraud is not proved, the sale will not be set aside even though made in disregard of the statute. These states are:

Alabama	Louisiana	Oklahoma
Delaware	Minnesota	South Carolina
Florida	New Jersey	Tennessee
Georgia	North Carolina	Wyoming

The statute of South Dakota provides that failure to comply with the provisions of its statute regulating the sale of goods in bulk shall render the purchaser liable to any creditor of the original owner of the stock or fixtures for his pro rata share of the proceeds of such sale.[8]

SELECTED REFERENCES

BREWSTER, S.F.: "Legal Aspects of Credit," Pt.V, chaps. 25, 26, 27, 28, and 29.
ETTINGER, R. P., and GOLIEB, D. E.: "Credits and Collections," chap. 15.
Uniform Sales Act.

[8] The Credit Man's Diary and Manual of Commercial Laws.

CHAPTER XXIV

FRIENDLY ADJUSTMENTS

Reasons for Amicable Adjustments.—It happens quite frequently that a concern is not insolvent in the sense in which the term is construed under the Bankruptcy Act, where the liabilities exceed the assets at a fair valuation; yet it may be insolvent in the commercial sense, inasmuch as it is no longer able to meet its obligations as they mature in the ordinary course of business. Such a concern may have a substantial equity in the business, *i.e.*, an actual surplus of assets over liabilities, but it probably is "land poor," inasmuch as its equity consists in fixed properties which cannot be readily converted into cash with which to pay current debts as they fall due. Thus, it may be insolvent in the ordinary sense, continue in business indefinitely while in such condition, and yet remain immune from bankruptcy proceedings. This condition may be due to a number of causes, some of which are merely superficial and others more real and fundamental.

Among the causes of insolvency most frequently cited are incompetence, lack of working capital, and fraud. In general, all failures may be classified according to the causes which produced them into two major divisions, the first division comprising failures the causes of which lay within the business itself, and the second division containing insolvencies which are considered not to be due to the faults of those failing. Insolvency of the latter type may be caused by certain specific conditions beyond the control of the failing concerns, such as wars, floods, and disasters, or by failures of others; whereas insolvencies falling in the first classification consist primarily of incompetence, such as overbuying or careless selection of a stock of goods, unwise credit granting, carelessness in following up collections of outstanding accounts, inaccurate accounting system, poor business location, or any one of numerous other causes generally lumped under "bad management"; or lack of adequate working capital ordinarily caused by more funda-

mental or real factors, such as failure to keep a sufficient amount in liquid form or an injudicious disbursement of capital in interest and dividend payments.

Once a debtor becomes insolvent, there are several possibilities whereby he may either be extricated from his financial embarrassment and a readjustment worked out, or his property seized, liquidated, and distributed among his creditors. Thus, the insolvent debtor may ask for an extension or otherwise effect an adjustment with his creditors; he may make an assignment of all his property for the benefit of his creditors; or a receiver may be applied for by the debtor or his creditors. Finally, there is a possibility, if insolvency occurs in the sense that his assets at a fair valuation fall short of satisfying his liabilities, to go into bankruptcy voluntarily, or to wait until forced into bankruptcy by his creditors. Each of these steps will be given adequate treatment in the present and subsequent chapters.

From the foregoing it is apparent that there is a certain degree of risk involved in all business and that it is inevitable that some debtors should become financially embarrassed either because of conditions inherent in the business itself or because of external factors absolutely beyond the debtor's control. As soon as an account assumes a serious aspect and it is discovered that the debtor is unable to meet his obligations, creditors should act with the utmost care and caution and with great hesitancy before resorting to any drastic measures which may cause the bankruptcy of an honest merchant. Instead, they, or an adjuster representing them, should come to the insolvent debtor with a view not only to obtaining an immediate settlement but also to serve in a more constructive way by making an adequate diagnosis of the causes responsible for the particular situation of the debtor and applying proper remedies, in order to save the assets and rehabilitate and preserve the business. Such a policy of friendly interest in the readjustment of the debtor's business affairs is not only the most human, but also proves itself the most profitable in the long run, inasmuch as it practically always results in the acquisition of a loyal customer for the future.

Modes of Amicable Settlement.—In general, there are four ways in which an amicable settlement of an account owed by an insolvent debtor may be brought about. If it is discovered upon analysis that the debtor's condition is not serious and that by

applying proper treatment and furnishing the requisite assistance and cooperation his situation may be remedied and the business rehabilitated, the adjuster may find it desirable either to bring about immediate part settlement in cash or to recommend an extension for the full amount. Whenever the investigation discloses that the debtor's affairs are badly involved, it would be desirable to arrange for a composition settlement or to liquidate the business in a friendly manner and distribute the proceeds among the creditors.

In securing a settlement by an immediate part payment in cash, in order to protect the creditors, the debtor is usually required to give short-term notes for the unpaid balance. These notes may be given in a series, in which case it is provided that, in default of any one of the series, the balance becomes due immediately. In the absence of such a provision, each note must be sued on separately as it falls due.

EXTENSIONS

When to Grant an Extension.—An insolvent debtor frequently finds it to his advantage to consult with his largest creditors or with the adjuster representing them with a view to obtaining an extension of time in which to meet his obligations. If his financial responsibility is not seriously impaired and the causes of the insolvency are but temporary and remediable, an extension of time may be all that is needed in order to rehabilitate the impaired condition. Recognizing this fact, creditors should, from selfish as well as humanitarian motives, act with great hesitancy before refusing a request for an extension and resorting instead to drastic measures which will result in irreparable injury to the honest debtor and his dependents by placing the stigma of bankruptcy upon them. At the same time, these drastic steps, by precipitating the debtor's bankruptcy, preclude the possibility of continuing profitable business relations with the debtor.

Prior to granting of an extension, however, creditors should satisfy themselves that the debtor is honest. Dishonest debtors are not entitled to any consideration on the part of their creditors. Furthermore, if the debtor lacks the all-important quality of honesty and integrity, an extension of time will simply afford him an excellent opportunity to perpetrate a fraud upon the innocent creditors. As a means of protection, therefore, it

is of utmost importance to ascertain whether or not the debtor possesses the necessary qualities of character and good moral fiber before any favorable decision is to be reached in acting upon his request for an extension.

Another consideration for creditors to ponder upon before granting an extension is the seriousness of the debtor's embarrassment and the causes therefor. If the weakness is but temporary and there is reason to believe the debtor sufficiently capable of continuing in business and extricating himself from his difficulties, there is no reason why creditors should not lend their assistance and cooperation in order to effect a quick recovery. Where the causes are temporary and curable, the prospects for improvement are very bright. Thus, it frequently happens that a merchant has too much capital tied up in salable merchandise inventories, or in accounts receivable which are good and collectible, but slow-paying. In either of the cases cited an improvement in collection methods aided by a lapse of time will usually remedy the weaknesses they produced. On the other hand, if the debtor is likely to require large quantities of additional merchandise in order to continue in business and meet the demands of his trade, it behooves the present creditors, if an extension is granted, not only to pledge their moral support but also to supply the debtor with fresh merchandise to replenish his stock, for when a debtor exposes his financial responsibility by requesting an extension, his credit standing in all markets is at once impaired, thereby automatically shutting off his credit in new markets. To the extent to which he finds it impossible to secure new credits, to that extent he must rely upon his old creditors, whose failure to supply the necessary stocks precludes any possibility of paying the original indebtedness for which an extension is requested.

Method in Granting Extensions.—One of several methods may be followed in arranging for an extension. If an adjuster represents and acts as agent for all or a majority of the creditors, the commonest method is to execute and enter into a trust agreement between the debtor and the adjuster. In all cases where an adjuster is sought to represent them, creditors should assign their claims to him, thereby enabling the debtor to deal with one instead of a large number of creditors located at a distance from him. Unless claims are thus assigned it would be difficult to work out and consummate the proposed settlement, by reason

of the possibility of one or two creditors retarding settlement by neglecting to give their assent or by insisting upon a prompt settlement or else threatening to take drastic action. From the creditors' standpoint it is equally desirable to seek an adjuster to represent and act for them, because of the pressure which such action brings to bear upon the debtor. The debtor is thereby made to feel that all creditors are cemented by a common interest, acting in unison as an individual through the medium of the adjuster, and should he compel legal action by his refusal to submit to terms, such action is greatly simplified.

The trust agreement provides for a continuation of the business by the debtor himself under the supervision of the adjuster, who is usually a representative or the manager of an adjustment bureau, or places the business under the direct control of the latter until the original indebtedness is fully paid for.

Legal Aspects of Extensions.—An agreement by one creditor to give a debtor an extension of time, without any consideration therefor, is not binding on the creditor. This is on the ground that every contract or agreement must be supported by some consideration in order to be binding. Where, however, two or more creditors agree among themselves and with the debtor, that in consideration of each creditor's forbearance each of the other creditors will agree to an extension, there is deemed to be adequate consideration to support the promise of each creditor. Once such an agreement is entered into, no one creditor, at least without the consent of all others, would have the right to demand payment before the expiration of the extended time.

If the debtor gives the creditor a note or other security, including guarantees, in consideration for an extension of time granted, the agreement is binding and the creditor would have to wait until the expiration of the extended period before he would have the legal right to bring action against the debtor. The principle underlying this is that the giving and the acceptance of the note or other security in place of the old account constitutes a substitution of a new contract for an old one and is, therefore, equally binding on both parties.

COMPOSITIONS

Nature of Composition Settlements.—At common law a composition is a contract entered into by an insolvent debtor

and two or more of his creditors (not necessarily all) whereby, in consideration of the mutual promises of the creditors to release the debtor from the balance of his indebtedness, the debtor settles the claims against him at an agreed percentage of their face value. A mere agreement of one creditor alone would not be binding, for lack of consideration. It is essential, therefore, that two or more creditors enter into the agreement, which is not binding upon any who do not accept.

As soon as such a composition is confirmed, it constitutes in effect a discharge or release from further obligation to all agreeing creditors, not by the operation of law, as in the case of bankruptcy compositions, but through the mutual consent and valuable consideration.

It is sometimes possible to force a proposed composition settlement upon clamorous creditors. If a large number of creditors agree to the proposition, in order to force the remainder to become parties to the agreement, suit is filed by three or more creditors in the Federal district court, to have the debtor adjudged a bankrupt. Before the adjudication, however, the debtor asks for a creditors' meeting for the purpose of submitting terms of compromise, and effecting an adjustment. Bankruptcy proceedings are stayed and a meeting of creditors is called. At the meeting the debtor is examined and then submits his terms. A majority of the creditors in number and amount agree to the proposed settlement. An application is made to the court for the confirmation of the adjustment. In this manner the debtor obtains the desired relief, without being adjudged a bankrupt.

A composition settlement is usually the result of the debtor's initiative. He submits the terms of compromise offering to pay a certain percentage of the claims held against him. The proposal may be submitted to the creditors individually, or at a creditors' meeting called for the purpose. The latter is preferable, particularly when the creditors are numerous and widely scattered.

When to Agree to a Composition.—This form of settlement, not unlike that of extensions, should be agreed to by creditors from selfish and humanitarian motives. Let us assume that the insolvent debtor's balance sheet shows a deficit of 20 per cent, *i.e.*, the liabilities exceed the assets 20 cents on the dollar. If the valuation is conservative, the business is worth 80 per cent of the liabilities as long as it remains a going concern. A

forced liquidation, however, would result in the realization of much less than the book value of the properties. Furthermore, if the business went through bankruptcy proceedings, much of the proceeds from a forced sale would be dissipated by expenses incident to such proceedings, until a settlement of 25 per cent would begin to look generous. Obviously, it is much more business-like for creditors to accept a settlement of 45 per cent and leave the debtor the remaining 35 per cent with which to continue and rehabilitate his business and start anew and unencumbered. Even the losses actually sustained will under such circumstances be ultimately recouped in profits arising from continued business relations with the debtor. Such possibility would be completely precluded were the debtor forced through bankruptcy. In addition to what has been said in favor of such a settlement from the standpoint of creditors, there is the opportunity of dispensing with the time, trouble, and worry attending all bankruptcy cases.

Then, too, humanitarian motives should prompt creditors to agree to a composition settlement. Honest debtors are entitled to such consideration. In modern times, as a result of the spirit and widespread recognition of commercial interdependence, the idea prevails that the credit grantor is in a measure a partner in the debtor's business. Because of the risks involved in any business enterprise, losses must be expected and the creditor should stand ready to bear his proportionate share. For these reasons offers made by honest merchants should be accepted and even encouraged, so that they may retain their business and save themselves and their dependents from disaster and the stigma of bankruptcy.

Offers for such settlement should never be considered when any suspicion of fraud attaches to the insolvency. Creditors should assure themselves beyond the shadow of a doubt that fraud is entirely absent. Otherwise, they should refuse to agree to a composition. Moreover, they should relentlessly prosecute such debtor to the fullest extent, immediate selfish motives to the contrary notwithstanding. Creditors owe it not only to themselves but to their fellow merchants to prevent the perpetration of fraud on the part of dishonest debtors wherever possible. It is the greatest protection against future attempts to secure merchandise fraudulently, that a creditor can buy,

for unscrupulous debtors stay shy of those who are willing to sacrifice large dividends in order to prosecute frauds.

FRIENDLY LIQUIDATIONS

When the debtor's affairs are so badly involved as not to warrant the granting of an extension and no terms of composition can be agreed upon, there is but one other course to follow, namely, to wind up the estate and distribute the proceeds among the creditors. This result may be accomplished through the medium of an adjustment bureau; through a legal assignment executed by the debtor; or through bankruptcy proceedings.

Origin of Adjustment Bureaus.—The conditions prevailing prior to the establishment of the bureaus are responsible for their origin and tremendous development. Concerted action on the part of creditors, prior to the organization of adjustment bureaus, in dealing with a failing debtor was practically unknown. The insolvent estate was frequently dissipated, leaving nothing for the creditors. Receivers, trustees, and appraisers appointed in the course of bankruptcy proceedings were often incompetent or friendly to the debtor. Fraudulent debtors frequently escaped punishment and honest debtors were made to suffer on account of action taken against them by overzealous creditors. Waste and maladministration were common in the handling of all cases involving credit breakdowns. In a word, the methods of procedure in winding up an estate were clumsy, haphazard, and expensive.

To secure more effective cooperation of creditors in dealing with embarrassed merchants, many of the various lines of trade have organized within their respective industries and have established local representatives or secretaries in the larger market centers for the purpose. The National Association of Credit Men, in particular, has been instrumental in the development and widespread use of such mediums by establishing local adjustment bureaus within their own organization.

Aims of Adjustment Bureaus.—Adjustment bureaus of the National Association of Credit Men operate at present in 85 market centers, located in 36 different states and in the District of Columbia. They are departments of local associations of credit men or are affiliated with them. If the bureaus are independent organizations, the local association of credit men is given representation on the Board of Directors. The bureaus

are under the close and constant supervision of the manager of the National Adjustment Bureau Department of the National Association, as well as under close scrutiny by committees of local credit men. They are organized for altruistic purposes—for service and not for profit. Their aims and objects have been set forth by the first committee appointed by the National Association of Credit Men in its report submitted in 1906 as follows:

1. To investigate, upon request, the affairs of a debtor reported to be insolvent and to adjust the estate, when possible, without court proceedings.
2. To secure capable and efficient receivers, appraisers, or trustees when court proceedings are found to be necessary.
3. To secure quick adjustment of all honest failures at the minimum cost and with the maximum dividend to creditors.
4. To facilitate and economically to secure extensions or liquidations when, upon investigation, it is found to be to the best interests of all.
5. To influence concerted action by the creditors for the benefit of all.
6. To assist creditors to acquire for their own use the estate of failing or insolvent debtors, when mutually agreed upon.
7. To prosecute or assist in the prosecution of the guilty party or parties where investigation discloses fraud or the intent to defraud.[1]

Functions of Adjustment Bureaus.—All activities of these bureaus may be divided into four parts. The first function consists in personal investigations made by representatives of the bureau upon request of a member of the National Association of Credit Men. These representatives investigate the debtor's condition and adjust the account. A second function is that of effecting friendly adjustments, including service in a fiduciary capacity in any action of any character except bankruptcies. These adjustments are made in behalf of two or more creditors and for the common good of all. Bureaus are also equipped to serve in a fiduciary capacity during bankruptcy proceedings. Bureau representatives attend all hearings and otherwise investigate all bankruptcy cases, irrespective of whether or no a representative of the bureau is elected receiver or trustee. Finally, some bureaus are equipped to handle collections in their respective zones or to forward them for collection to other bureaus and attorneys. It should be observed at this point that every collection item is received by a bureau with the understanding that,

[1] *Bulletin*, National Association of Credit Men, July, 1906.

should developments warrant action in behalf of all creditors, the interest of the one who submitted the account for collection becomes subservient to the interests of all.

The main purpose of all bureaus, and the sole activity in some of them, is to handle in behalf of all creditors the affairs of insolvent and embarrassed debtors, whether in friendly adjustment or in bankruptcy. Of these two functions, the first is performed by all, whereas the latter constitutes one of the chief activities of 82 out of the 85 bureaus. As many as 65 of the bureaus are also available for investigation service, while only 48 handle collection items. These adjustment bureaus act for creditors who are not members of the association as well as for members.

Bureau Procedure.—When an account falls under suspicion, through unreasonable delinquency or other cause, the bureau nearest the debtor's town will, upon request of one or more creditors, and sometimes after a consultation with other creditors, conduct a thorough investigation into the debtor's affairs. As a result of these investigations it makes its recommendations to the creditors and advises such action as the circumstances suggest.

If circumstances seem to warrant the granting of an extension, such action is recommended. When approved by the creditors, a trust agreement is entered into by the debtor with the bureau. Under these circumstances, the debtor may retain and continue the business himself, or he may be retained as an employee of the bureau representative who is placed in charge until all original indebtedness is paid in full. To be successful in the operation and rehabilitation of temporarily defunct enterprises, it devolves upon every bureau to keep in touch with a group of efficient merchandising men who could effectively represent the bureau in such ventures, by increasing sales volume, stopping leaks, collecting receivables, and in every way reducing the cost of doing business.

Should it be deemed advisable to effect a common law composition settlement, the adjustment bureau is well qualified to play its part. Such terms, when presented by the debtor to his creditors individually, or even at a creditors' meeting, invariably meet with some serious opposition from a few obstreperous creditors. Furthermore, some creditors usually retard and delay the consummation of a proposed settlement because of

their indifference or neglect to give their assent. These difficulties are but multiplied when there are numerous creditors widely scattered and located at a distance from the insolvent debtor. Adjustment bureaus usually investigate with great care the merits of proposed compositions. When an adjustment bureau recommends a composition, therefore, creditors are likely to consent to it without much delay, because they realize that the bureau is probably obtaining the most advantageous settlement possible under the circumstances. Besides, creditors feel a strong moral obligation to follow suggestions made by the bureaus, for these bureaus are subsidiaries of, and are sponsored by, their own organizations. It naturally follows that, as members, it devolves upon them to give their generous support and further in every way possible the activities of their organizations, which, as members, they voluntarily indorse. Moreover, if the bureaus give evidence of unfair treatment or inefficiency, credit grantors feel that they can appeal to an agency of investigation and control superior to that enjoyed under any other method of dealing with embarrassed concerns. The National Association of Credit Men will not, knowingly, permit, for a minute, inefficiency or faithlessness on the part of adjustment bureaus, thereby making, at least potentially, for well-qualified and efficient organizations for the handling of claims.

If it is thought more desirable to liquidate the business and wind up the estate, the adjustment bureau will accomplish the purpose in a much more efficient and equitable manner than could be secured through a legal assignment or bankruptcy proceedings. The chief merits of the first plan are that it dispenses with the objectionable features of legal process. It leaves no stigma attached to the debtor; it liquidates insolvent estates at a minimum cost, thereby saving unnecessary expense and excessive fees of attorneys and officials; and the proceeds derived from the sale of the insolvent's property are considerably larger, inasmuch as the assets are sold by more competent individuals and in a more advantageous manner than in bankruptcy proceedings.

The bureau plan calls for an assignment by the debtor of all his property not exempt by law to a trustee designated by the bureau, for the benefit of all creditors. The debtor also produces his books and records and permits a complete and thorough investigation of his affairs. The facts in the case are then

submitted to the creditors, who are asked to file their claims with the bureau, which gives the debtor a release as soon as the property is assigned to it. The bureau collects the outstanding receivables, takes charge of the assets, and disposes of them to the best advantage in one of three ways:

1. It may sell them at public auction.

2. It may sell the stock in relatively small quantities to buyers of bankruptcy stocks and to storekeepers at private sale, which is usually superior to public auctions.

3. It may continue the business and gradually dispose of the stock at retail, should the nature of the business warrant it. In this manner higher prices may be realized on the stock. The only drawback to this method of procedure, aside from the requisite waiting until all the stock has been disposed of before any dividends are paid, is the necessity of furnishing additional merchandise to replenish the stock in order to meet the demand of the trade.

Irrespective of the method followed in disposing of the insolvent's estate, creditors are, as a rule, compelled to wait at least four months after assignment before they are paid any dividends. The reason for such delay lies in the unwillingness and inability of adjustment bureaus to assume any risk in case previously unheard-of creditors appear and demand payment after the estate has been wound up but before the four months' period has elapsed. A petition in bankruptcy could be filed by these creditors, the assignment set aside as a preference, and the adjustment bureau compelled to account for all sums received from the sale of the bankrupt's assets. Should dividends be disbursed immediately, the bureau would find itself in an embarrassing position. It is for this reason that no payments are made by the bureau until the expiration of at least four months from the date of the assignment.

Should it develop that the debtor has not been fair to his creditors, and if these creditors should on this account refuse to consent to the friendly liquidation, bankruptcy is the inevitable result. This rarely happens, unless there are some legal complications or suspicion of fraud. Bankruptcy proceedings may also become unavoidable because the debtor himself has filed a voluntary petition. Under such circumstances the bureau acts in an advisory capacity and represents creditors at their meetings, and particularly in the election of a trustee. The

bureau itself frequently acts as trustee in bankruptcy through one of its representatives, and a large majority of the credit grantors file their claims with it, primarily, because they have a disinterested party act as trustee, and, secondarily, because it helps to keep the estate out of the hands of "bankruptcy rings" or persons who sometimes see "good picking" in insolvent estates.

"Bankruptcy rings" have been organized in some large trade centers with the object of obtaining control of the assets of bankrupt estates. When creditors cooperate through the adjustment bureaus, these rings find themselves powerless. In this manner alone, bureaus have saved large sums of money in preventing estates from falling into their clutches.

Another purpose of the bureaus is to investigate bankruptcies where there is a suspicion of fraud. As soon as sufficient evidence is obtained to warrant action, the facts are presented to the grand jury, the Department of Justice, or other authorities. These bureaus cooperate with the Investigation and Prosecution Department maintained by the National Association of Credit Men. This part of their activities serves to protect not only their members but also honest debtors to whom the members sell.

Advantages of Adjustment Bureaus.—The bureaus are instruments for the adjustment and liquidation of insolvent estates and for the reorganization of embarrassed concerns by creditors themselves, who are more directly and deeply interested in economical administration and the elimination of waste and unnecessary expense. It is but natural that insolvent estates should be liquidated to better advantage by creditors than by a court and individuals who have nothing at stake.

Adjustment bureaus usually have skilled appraisers and competent attorneys and merchandising men to place in charge of the affairs of insolvent debtors. In addition, they keep in touch with special avenues through which merchandise inventories can be disposed of regularly to greatest advantage. The charges seldom exceed 7 per cent of the amount distributed as dividends, except where special services of an unusual character are rendered. Average returns to creditors from friendly liquidations conducted by the bureaus compare very favorably with amounts secured through bankruptcy proceedings, the former varying from 50 to 60 per cent, whereas the latter approximates

25 to 30 per cent on the average. In many instances, dividends distributed by the bureaus have amounted to the full amount of the claims. Even in bankruptcy cases the presence of the bureaus has resulted in higher dividends and in more economical administration.

Another advantage of friendly adjustments through the bureaus is the equal division of economically closed estates among all creditors ratably, which they aim to attain. It gives a better return than does a policy of enforcing an undue advantage on the part of a few obstreperous creditors by threat to disturb a proposed adjustment.

The tendency to bring about concerted action and to develop cooperation among credit grantors is a third advantage of the bureaus. The value of such cooperation and harmony in our complex system has already been sufficiently demonstrated by the experiences of numerous concerns.

A fourth advantage lies in the constructive features of their work. Some of them already are concentrating their attention and energy to analyzing, solving, and prescribing for the commercial ills encountered by unfortunate but honest debtors. In addition to the normal functions of collecting accounts, investigating commercial crooks, and liquidating insolvent estates, responsible and progressive bureau managers feel the responsibility of making adequate diagnoses and of applying proper remedies so that the weak concerns may be rehabilitated and their assets saved and preserved. By reason of their superior organization and wide experience in dealing with embarrassed or insolvent concerns, adjustment bureaus are well qualified to offer such assistance as is needed in order to extricate honest and deserving debtors from their present difficulties.

Finally, there is the advantage of combating commercial crooks and frauds by keeping under vigilant observation all activities of merchants who have in mind fraudulent failures.

Because of these advantages, adjustment bureaus everywhere are growing in number and importance. Both debtor and creditor are beginning to realize that these organizations are vitally interested in the welfare of both and work to their mutual advantage.

Example of Friendly Adjustments.—An excellent example of what an adjustment bureau can accomplish in the handling of an estate which was apparently so badly involved as not to

admit of any reorganization is afforded by a recent case handled by the Adjustment Bureau of the Chattanooga Association of Credit Men.[2] No less than 482 creditors, many of whom were located at a distance, were interested in the insolvency, involving claims amounting to $220,701.68. The interesting feature of it all is that the bureau succeeded in convincing all of the 482 creditors that it was the proper medium through which to act and all consequently agreed to the same proposition.

In order to prevent some creditors from forcing the concern into bankruptcy, no assignment or transfer of the property was made to the bureau. Instead, the merchandise and fixtures were sold in bulk and after the legal notice had been sent out by the purchaser, a meeting of the principal creditors and the debtors was called. The seller, in writing, gave at that meeting a creditors' committee, appointed for the purpose, full powers to liquidate the affairs. As a result, the liquidation of this large estate involved an expenditure on the part of the bureau of 2 per cent of all claims, the case was kept out of the courts, and the creditors have already received at the time of this writing 65 per cent on their claims. Such large dividends secured at such a ridiculously low expense are possible only by the cooperation of creditors through an efficient adjustment bureau operating not for profit and in behalf of all the creditors.

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CHAPTER XXV

ASSIGNMENTS AND RECEIVERSHIPS

ASSIGNMENTS

Nature of Assignments.—Assignments for the benefit of creditors are voluntary transfers in trust by debtors of some or all of their property to an assignee for the purpose of applying such assets or the proceeds thereof to the payment of some or all of their debts and returning the surplus, if any is available, to the assignor. Every state has some form of law whereby property may be turned over by a debtor to an assignee for the purpose of sale and division among the assignor's creditors *pro rata*. The power or right to assign property in trust for the benefit of creditors is recognized and approved by the various state and Federal courts, except that assignments may be set aside on the ground of fraud or when used as a preference under bankruptcy proceedings. Assignments are generally resorted to by debtors who, because of insolvency, find themselves unable to pay their obligations in full or to continue in business.

Advantages of Assignment.—Although assignments on behalf of and for the benefit of creditors are a form of legal process similar to bankruptcy, they possess, nevertheless, several advantages of friendly adjustments. Considerably less publicity is attached to this form of settlement than to bankruptcy proceedings, requiring only notice to the creditors; otherwise, the administration of the assignment is practically private. Furthermore, creditors may conduct the business as they see fit and dispose of the estate to the greatest advantage, since there is no definite time limit in which settlement must be made, although in some states the judge may grant an order directing the assignee to show cause within a specified number of days why a sale of the assets should not be had or why dividends should not be paid and a settlement of the account arrived at. It is not necessary, however, to dispose of the property at a forced sale and, consequently, at a great discount, as in case of bank-

ruptcy proceedings. Finally, the cost of administration is greatly reduced under a voluntary assignment and the dividends are, therefore, larger in proportion.

Limitations of Assignment.—The most important limitation is that an assignment constitutes an act of bankruptcy, making it possible for creditors to take the administration of the estate out of the jurisdiction of the state insolvency court, by filing a petition in bankruptcy. Because of the reduction in expenses incident to administering the business by an assignee over bankruptcy proceedings, few creditors have taken advantage of the fact that an act in bankruptcy is committed as soon as an assignment is made by an honest debtor to an equally honest and capable assignee. To be sure, only where absolute confidence is had in the integrity and good intentions of the debtor should creditors give their consent. This is so because consent to an assignment estops the creditors giving it from filing a petition in bankruptcy.

Another important limitation consists in the restricted territorial operation of the laws under which assignments are made. Insolvent laws of one state cannot discharge obligations to citizens of other states, because they have no extraterritorial operation or effect. Furthermore, legislation of the states is supreme within the jurisdiction of the respective states only in the absence of legislation by Congress. Thus, the Federal Bankruptcy Act supersedes any state law, thus limiting the possibility of obtaining a release from further liability for debts, even in states where such a discharge is authorized by the insolvency laws.

A third weakness of assignments lies in the lack of uniformity in the laws and requirements in the various states. In practically every large failure the insolvent's assets are not wholly within one state nor do all his creditors reside in one state. No complete discharge is, therefore, possible of attainment, because in some states debtors may not be released from further liability for their debts under the insolvency laws. Similarly, no decision of a majority of creditors can bind creditors who are citizens of other states. Again, although in most states the assignment must be recorded in the county clerk's office in which the debtor resides or has his principal place of business, together with a sworn schedule of the assets conveyed in trust and a list of creditors, yet in some states these requirements are omitted.

A fourth objection is the lack of direct effective supervision over the assignee in the administration of the estate. Debtors have the power to appoint their own assignees and in some states they are not compelled even to consult the creditors or to obtain their consent to the appointment, unless it could be reasonably shown to the judge that the assignee selected is not qualified and capable of serving in that capacity. To be sure, the assignment is frequently made to one of the creditors, or, where no assignee is named in the assignment, he is selected by the court. Nevertheless, the selection and appointment of a person to fill this all-important office is in the hands of the debtor almost entirely.

Assignment Procedure.—The general requirement is for assignments to be made in writing in order to give effect to the assignments themselves and to serve as protection against fraud or collusion. Written instruments are expressly required by the statutes where real property is subject to the assignment either in whole or in part. Two schedules are ordinarily appended to the appraisement. These schedules are properly identified and referred to in the body of the instrument of which they form a part. One is a schedule of the property conveyed to the assignee; the other is a list of the assignor's creditors for whose benefit the assets are appropriated.

Executing the Assignment.—Execution of the assignment is the next step in the proceeding, following the preparation of the instrument and the schedules attached thereto. The instrument must be under seal in most states, particularly when real property is involved. Both the assignment and the schedules must be executed, first by the assignor or an attorney acting for him under a valid power of attorney, then by the assignee, if formally named as a party to the assignment. Otherwise, the assignee need not sign the instrument, but it is considered executed by him upon acceptance of the instrument when delivered by the assignor, and entrance upon the performance of the trust. Some state laws require a formal acceptance by the assignee. Execution must be made before witnesses and in some states it must be sworn to by the assignor.

Recording the Assignment.—Recording the instrument is the third step to be taken. A certain time is usually specified within which the instrument must be recorded in some public office in order to be valid. Thus, the New York statute provides that

the assignment shall be recorded in the county clerk's office where the debtor resides or in which he has his principal place of business. The statute also requires the debtor to file with the county clerk, 20 days after the date of the assignment, a sworn schedule showing a list of his creditors and a complete inventory of his property. Should the debtor refuse to file these schedules, the Supreme Court of the State of New York or the county judge can, on the application of the assignee, compel the debtor to supply the necessary data to enable the assignee to file these papers. Furthermore, if the assignee fails to file these papers within 10 days or such other time as the court may allow, any creditor can apply for an order to remove the assignee. A certified copy of the assignment must also be filed in the county or counties, outside the one in which the original is recorded, in which real property subject to the assignment is situated.

Delivery of Assignment.—To make the act valid, it is necessary that the transfer be completed by delivering the assignment to the assignee. Failure to do so may render the act void and fraudulent against judgment creditors.

Delivery of Property.—Following the delivery of the assignment, possession of the property itself must be delivered. It has been held by some state courts and in the Federal courts that retention of the property by the assignor after the deed is executed makes the transfer void and fraudulent against creditors. It is, therefore, advisable that delivery of the property accompany or immediately follow the deed involving a transfer to the assignee.

Securing Assent of Creditors.—The assent of creditors is always required to give the assignment validity, provided the assignment is made directly to the creditors, in which case they constitute a party to the contract. If, however, the assignment is made to a trustee for the benefit of creditors who are not parties to the agreement, their assent is not required in order to make the assignment valid against judgment creditors.

Assent, where required, may be indicated by formally consenting to the deed, or by accepting the benefit of the trust. Even where assent is required by law, it is not necessary that all creditors should agree in order to make the transfer valid. As a rule, only the assent of creditors sufficient in number and amount to cover the value of the assets assigned is considered requisite.

Notice of the Assignment.—Upon receiving the assignment from the debtor, the assignee executes a bond guaranteeing faithful performance of the trust, takes possession of the property specified in the schedule, and gives public notice of the assignment to the creditors if required by the state law. In some states, recording the assignment constitutes sufficient notice. Where required, notice is usually given by advertising in one or more newspapers that an assignment has been made by the debtor of his estate for the benefit of his creditors. Creditors are also requested to file their claims with the assignee, and debtors to account and pay their obligations. Debtors thus informed cannot defeat the rights of the assignee by paying the insolvent debtor.

The New York statute also provides that, if the judge so orders, 10 days' notice must be given, to all parties interested in the estate, of:

1. All proposed sales of property.
2. Declaration and time of payment of dividends.
3. The filing of the final account of the assignee and of the hearing thereon.
4. The proposed compromise of any controversy.[1]

Upon receiving notice of the assignment, creditors may accept the provisions of the contract, disregard it entirely, or reject it as fraudulent or illegal. Acceptance may be signified by signing the instrument if creditors are parties to it, by presenting their claims for payment, or by notifying the assignee of intention to accept. If it is thought that the assignment involves fraud or other illegality, non-assenting creditors may treat it as a nullity and proceed to enforce their claims as though no assignment had been made, or else institute proceedings to set it aside by having it declared void and fraudulent. The last action is open only to judgment creditors who have not previously confirmed the assignment by receiving a benefit under it.

Liquidation of Estate.—Proper steps are then taken by the assignee to collect the debts assigned and to dispose of the property at the earliest time possible, consistent with the best interests of the creditors. Provision may be made in the assignment that the business be continued for a limited time. The obvious purpose of this provision is to secure a more advantageous execution of the trust. Sometimes the assignee may continue the

[1] "The Credit Man's Diary and Manual," 1923, p. 78.

business even though no special authority is contained in the assignment. Thus, he may continue the business of the debtor, if a manufacturing concern, in order to convert the raw material on hand and complete the goods in process into finished products. But if he continues the business beyond this point, he does it at his own risk and is held accountable for all losses incident to such unauthorized operations. In some states, the court is given power to authorize the assignee to continue the debtor's business for a limited period.

One of the most important functions of the assignee is to dispose of the property assigned by sale. He is forbidden to appropriate it for his own use even when he pays the full price. In making a sale, the assignee must act in good faith and exercise a certain degree of prudence and diligence. Otherwise, he becomes personally liable to the party suffering from his alleged misconduct to the extent of the loss incurred. No time is stipulated in which he is bound to sell the property, for to do so would result in lower prices and hence smaller dividends to the creditors in whose behalf the trust is executed. On the other hand, if the assignee delays unreasonably in disposing of the property, the delay may be considered evidence of fraud and the court may grant an order directing him to show good cause why a sale should not be had.

Sales may be private, or public, in the discretion of the assignee, unless definitely provided in the assignment. In the absence of express directions, it is advisable to offer the property at a private sale, and if a fair price cannot be thus secured, to sell it at auction, after giving due notice of the proposed sale to creditors. In some states the assignee is forbidden to sell on credit, while in others he may use his discretion regarding the terms of sale.

Deductions.—Out of the proceeds of the sale all expenses incident to the execution of the trust are deducted. These deductions are usually provided for in the assignment, and are made out of the first sums obtained from the sale. These deductions should cover the cost of advertising, insurance, interest, taxes, salaries, wages of employees, rent, the cost of suits concerning the property assigned, and commissions of the assignee.

Compensation of Assignees.—Assignees are allowed compensation for their own time and services, in addition to reimbursement of their expenses. The amount of compensation is either

stipulated in the assignment or fixed by agreement independently of the assignment. In the absence of express stipulation or agreement, the assignee is in most states entitled to a reasonable compensation similar to that allowed by law to trustees, guardians, and executors. In the state of New York, for example, compensation of the assignee is fixed by law and consists in a commission not exceeding 5 per cent of the entire amount which comes into his hands, unless the aggregate of such commission amounts to less than $200, when the court may allow up to that sum. This is in addition to necessary expenses approved by the court, and to an extra sum paid for continuing the business. It should be observed that the receipt of compensation by the assignee is entirely contingent upon the performance of the duties of his office. He forfeits all compensation if found guilty of gross carelessness or misconduct; and if found guilty of maladministration or of refusal to account, not only his compensation may be refused but also the necessary expenses.

Distribution of Dividends.—After all the necessary deductions are made out of the proceeds of sales and collections, it devolves upon the assignee to distribute, without unreasonable delay, the sums remaining in his hands among the creditors who are entitled to the benefits of the trust. Such sums may be distributed in one payment, or in the form of several successive dividend payments.

Not unlike bankruptcy proceedings creditors must be paid in case of assignments according to priority. Thus, for example, wages and salaries of employees for work done within three months of the assignment up to $300 per employee constitute preferred claims. In order to ascertain the order of payment and the amounts payable to each creditor, the assignee must consult the schedule of the creditors attached to the assignment, where such information can be obtained. If the information contained in the schedules is inadequate, the books of the assignor are considered proper evidence, while in some states additional proof explaining the claims may be introduced. Where proper information as to the amount or priority of claims is lacking, or where claims are conflicting, the assignee may apply to the proper court by motion or a bill in equity, for directions.

Any surplus remaining in the hands of the assignee after all creditors who are entitled to participate are satisfied must be

turned over to the assignor. Amounts paid to the assignor before the debts for the payment of which the trust was created have been satisfied are subject to the appropriation for the benefit of all creditors whose debts were provided for by the assignment and remain unpaid.

Final Accounting.—The next step in the proceeding is for the assignee to render his accounts of all transactions, receipts, and disbursements to the assignor and the creditors. In a majority of states the assignee is required by law to present his accounts to the court for examination and approval before obtaining a discharge from the trust. In any event an accounting must be made to the creditors, else they may compel it by filing a bill in equity forcing the assignee to render a full and accurate account or to be liable for the value of the property sold by him.

Close of the Trust and Discharge of Assignor.—The last step in assignment proceedings is to close the trust and to secure a release from further liability on the debts covered by the assignment. The time for closing the trust is fixed either by the assignment itself, or by the lapse of a reasonable period of time. Where assignors may be discharged from further liability under the insolvency laws, such a discharge is usually granted on petition of the assignor and upon consent of creditors owning a certain percentage of the debts, usually two-thirds, of all creditors residing in the United States.

RECEIVERSHIPS

Nature and Purpose.—From the standpoint of the purpose for which a receiver may be appointed, all receiverships are divided into equity and bankruptcy receiverships. A petition for the appointment of a receiver in bankruptcy is filed simultaneously with the filing of the petition in practically all involuntary cases. Such a receiver is then appointed by the district court, with or without the consent of the alleged bankrupt. His principal duty is that of custodian of the insolvent estate, unless otherwise provided for by authority of the court, in which case the receiver may be allowed to continue the business for a limited period of time.

A receiver in equity may be appointed either by state or by Federal courts of equity. The jurisdiction of equity courts to appoint a receiver is based on the inadequacy of the remedy obtainable in the law courts. When a state court appoints a

receiver, the receiver can take possession of only the property in the jurisdiction of the court. Such court, however, has no jurisdiction outside of its own state; and for property of the insolvent located in other states, other appointments of receivers must be made by the respective state courts. To be sure, if no quarrel arises among the different sets of creditors who are citizens of more than one state, it is not unlikely that the courts of all states concerned will appoint the same person appointed by the court of the first jurisdiction. Even where this is the case, the delay in making the appointment and his responsibility to the several courts would involve expensive and serious delays and difficulties.

A receiver in equity is appointed by Federal courts on the petition of one or more creditors, addressed to the United States District Court, in an action brought for the benefit of the petitioning and all other creditors. To enable the Federal court to take jurisdiction and appoint a receiver, one or more of the petitioners must be citizens of a different state from that of the debtor, in order to give the necessary diversity of citizenship. Another requirement for the appointment of Federal equity receiverships is that the amount of the petitioners' claims must be in excess of $3,000.

Equity receiverships are resorted to when a debtor is insolvent, in the sense that he is unable to meet his current obligations, notwithstanding the fact that his assets exceed the total liabilities. Under such circumstances, the debtor could not be adjudicated a bankrupt. When thus situated, the debtor himself frequently seeks the protection of the courts from a forced sale by impatient creditors by applying for the appointment of a receiver. It is important to bear in mind that an equity receivership does not constitute an act of bankruptcy so long as the total assets of the debtor at a fair valuation are in excess of his liabilities.

The object sought by the appointment of a receiver is to preserve the estate for the creditors during the readjustment, reorganization, or litigation which is to decide the rights of litigant parties, and to establish a so-called moratorium on behalf of the debtor.

To warrant the appointment of a receiver, the court must be shown by the plaintiff that such action is necessary to prevent loss or injury to those financially interested. A mere default in

payment of an obligation is not sufficient ground to justify the appointment, for under such circumstances the ordinary processes of the law courts may be resorted to as a remedy. It is, therefore, essential to show that the plaintiff has a clear legal right to the property; or that he has a lien on it; or that it constitutes a special fund out of which he is entitled to satisfaction; or that the defendant obtained possession of the property fraudulently; or that the property or income from it is subject to loss from waste, misconduct, neglect, or insolvency of the defendant, and that the plaintiff's remedy at law, if a judgment creditor, has been completely exhausted or otherwise found inadequate.

Selection of a Receiver.—In the selection of a receiver the court exercises its discretion to a great extent. The person so appointed, however, must be an indifferent party to the litigation and not an agent or representative of either party in interest. He is an officer of the court and it devolves upon him to perform his duties in the interest of neither party but for the common benefit of all concerned. In appointing a receiver, therefore, the interests of all parties and the circumstances of the case must be adequately considered.

Another important, though not essential, requirement is that the person who is to act as receiver should not reside at a great distance from the property which he is to manage and control. Accordingly, some statutes provide that the person so selected be a resident of the state in which the litigation is pending.

A more important consideration in the selection of a receiver is his familiarity with the property and his knowledge of the business which he is to manage and control as agent of the court. For this reason it is advisable to appoint as receiver one who has been previously connected with the management of the property, provided he is impartial. Otherwise, it becomes necessary for the receiver to act under the directions of another person more familiar with the business or property he is to manage, and not upon his own responsibility. This condition of affairs is exceedingly objectionable, and for this reason the person to be appointed to fill the office of receiver is generally agreed upon by both parties prior to making the motion or filing the bill. If thus agreed upon, the court merely inserts the name in the decree.

Duties and Powers of Receivers.—It is the duty of a receiver in bankruptcy to take an immediate inventory of the estate of

the alleged bankrupt, seize all his books and records, close the place of business, unless authorized to continue its operation for a limited time, and, in general, to take all the necessary steps to collect and appropriate all of the property and effects belonging to the debtor, for the benefit of his creditors. Similarly, it is the duty of the receiver in equity immediately on his appointment to take possession of all the property of the debtor subject to the satisfaction of his creditors and to operate the business with essentially all the powers that the debtor had before his appointment. His operations are not, however, so much in the interest of the owners alone as they are for the benefit of all persons financially interested. Frequently, the receiver continues the business with the cooperation of creditors or a creditors' committee. Eventually, the business is liquidated or the receivership terminated and the property returned to the debtor. Sometimes, the business is thoroughly reorganized pending the receivership, which then terminates upon completion of the process of reorganization. This, however, is merely one form of liquidation.

When a receiver is appointed, the management of the property owned by the debtor is taken out of his hands and vested in the court appointing the receiver, who merely acts as an agent or officer of the court exercising its equity jurisdiction. Receivership does not change the nature of the legal rights of creditors, but while the property is in the possession of the court of equity no legal rights may be enforced except by express permission of the court. The apparent reason for the suspension of the legal rights is that the prompt enforcement of any creditor's or set of creditors' legal rights is likely to cause so much greater damage to other interested parties than the damage suffered by the delay of a few creditors that real justice demands a sacrifice of prompt enforcement for the greater good of all. For this reason the order appointing the receiver contains an injunction against creditors or other persons interfering with the property in the hands of the receiver, except by express permission of the court, and a person bringing action in one court against a receiver appointed by another court without the consent of the appointing court is guilty of a contempt of the latter court and may be punished accordingly.

On all large matters of policy and on questions outside of the ordinary matters of management and operation, the receiver

must apply to the court for authority and instructions. He is responsible for all his acts directly to the court appointing him, until he is finally discharged. He is not relieved, however, from liabilities incurred toward third parties. He is also liable for any fraud or negligence resulting in injury to the property subject to his management. To assure faithful performance of his duties, a receiver is usually required to execute a bond, the amount of which is fixed by the court and is determined by the value of the property to be entrusted to his care.

Receivers are also required to account to the court for all receipts and disbursements and are permitted to make no expenditures which will seriously diminish the funds entrusted to their charge without the consent of the court. Courts of equity are particularly strict in their requirements of accounts and records. Receivers cannot even be compelled to account to any party to a suit except through the intervention of the court.

Compensation of Receivers.—A receiver in bankruptcy under the Federal Act, when conducting the business, may receive an amount as the court shall allow, not exceeding 6 per cent on the first $500 disbursed to creditors by them directly or through the trustee to whom such moneys and property were turned over by the receiver; 4 per cent on an amount in excess of $500 and less than $1,500, 2 per cent on that from $1,500 to $10,000, and 1 per cent on amounts exceeding $10,000. In event of a composition settlement, his compensation is limited to one-half of 1 per cent on the amount paid creditors. When acting as a mere custodian of the property and not carrying on the business, his commission is limited to 2 per cent on all disbursements up to $1,000 and one-half of 1 per cent on amounts in excess of $1,000.

With respect to receivers in equity, some states regulate by law the matter of compensation, while in most states it is left entirely within the discretion of the court from which the appointment is derived, and is determined by the circumstances of the particular case. Some receivers under certain circumstances may be ordered, or may voluntarily consent, to serve without a salary. The fees of receivers appointed by Federal courts of equity are also left entirely within the discretion of the court. Because of absence of statutory provisions regulating fees of receivers in equity, their compensation frequently exceeds the

corresponding fees allowed in bankruptcy. A second probable explanation lies in the difference in the scope of activity.

Termination of Receiverships.—A receiver in bankruptcy remains in control of the bankrupt's estate until the first meeting of creditors which is to be called within 30, but not less than 10, days after the debtor has been adjudged a bankrupt. At this meeting a trustee is elected to whom all assets belonging to the insolvent estate in the possession of the receivers are transferred immediately. In all equity cases, receiverships are terminated by the appointing court when the necessity for the office ceases to exist. The cessation of the necessity for a receiver's functions does not in itself discharge the receiver. A formal order must be issued by the court to that effect either on his own application, when showing justifiable cause for the granting of the discharge, or by authority of the court itself to terminate that which it has itself created.

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CHAPTER XXVI

BANKRUPTCY

Conception of the Term.—The etymology of the word "bankruptcy" is somewhat in dispute. Among the various explanations offered is the following, which seems both plausible and authoritative. During the existence of the temple in Jerusalem, Hebraic custom required the deposit in the temple on certain occasions of sums of money. This money had to be in Hebraic currency, but since Roman coins were generally used at the time, money changers established places of business consisting of tables or benches (banks) on which they displayed their supply of Hebraic coins which were to be exchanged for Roman money. Money lending was another function which was later added to the practice of money changing. Some of these ventures proved unsuccessful and creditors, therefore, drove the failing money lender from his table or bench. Thus, he found himself "bench-broken" or "bench-rupted," bankrupted.[1]

Bankruptcy today, not unlike the days described in the preceding paragraph, consists of a condition coupled with an outward act. The condition is insolvency of the debtor, while the outward action to indicate the existence of that condition is a decree of bankruptcy handed down by a bankruptcy court instead of a physical act of destroying the bench. Thus, bankruptcy may be defined as a legal process whereby an insolvent debtor is declared a bankrupt, and his assets seized and equitably distributed among his creditors, after which he is discharged from further liability.

Early Legislation.—During the early days of the American Republic no crime brought so many to the jails and prisons as the crime of debt. Persons likely to get into debt were for the most part defenseless and dependent, and consisted of the great body of artisans, laborers, and servants. As one historian put it, "one hundred years ago the laborer who fell from a scaffold or lay sick of a fever was sure to be seized by the sheriff the

[1] Ettinger and Golieb, "Credits and Collections," pp. 331–332.

moment he recovered and be carried to jail for the bill of a few dollars, which had been running up during his illness at the huckster's or the tavern." The early laws were of a drastic nature, designed primarily for the protection of creditors. Because of the dependency of most debtors on their daily wages for their daily subsistence, a creditor's right of action against a debtor's property bore little significance. Hence, the surrender of the person of the debtor for his imprisonment was considered necessary to protect the interests of creditors. Many of the early bankruptcy laws provided the death penalty for the debtor and this was commonly imposed prior to the nineteenth century. No debtor had the right to petition himself into bankruptcy and be discharged from his obligations. The laws merely provided that creditors could under certain circumstances throw the debtor into bankruptcy, seize his property, and divide it among themselves. The balance had to be paid thereafter in the best way possible, else the debtor went to jail or prison.

Nineteenth Century Legislation.—Beginning with the nineteenth century, the views respecting the relationship between debtors and creditors underwent a decided change. The spirit of commercial interdependence had given rise to the idea that the creditor is in a sense a partner of the debtor. In accordance with this development and with the conception of business ethics, a more humanitarian feeling toward insolvent debtors was implanted in the hearts of the public at large, and new laws were consequently passed, first prohibiting the death penalty, and later abolishing imprisonment for debt. These laws merely held the debtor responsible to the extent of the amount of the property he possessed at time of failure.

Today the commercial world has progressed even much farther than the law. Creditors have established organizations, called "adjustment bureaus" and described elsewhere, for the assistance of failing but honest debtors, where cases are settled in a friendly manner without the publicity, expense, and delay of the courts attending bankruptcy proceedings. These quasi-public organizations not only cause the best results to be realized expeditiously, but also aid the debtor, in that they obviate the necessity of placing upon him the stigma of bankruptcy.

Article 1, Section 8, of the United States Constitution, provides that "Congress shall have power to establish . . . uniform laws on the subject of bankruptcy throughout the United States."

This has been interpreted to mean that a Federal Bankruptcy Act supersedes any act of the states, although the right to make a general assignment for the benefit of creditors is not precluded by the passage of the Federal Bankruptcy Act. Statutes providing for the discharge of a debtor from further liability, either to all creditors or to those who have actually proved their claims, upon the assignment of his property for their benefit, are entirely suspended by the Federal act.[2]

Under the power granted by the aforementioned clause of the United States Constitution, Congress has passed four different bankruptcy acts, in 1800, 1841, 1867, and 1898, respectively. The one in effect at the present time is that passed in 1898, and amended in 1903, in 1906, and in 1910.

Purposes of Bankruptcy Legislation.—Obviously, the necessity for bankruptcy legislation arises from the nature of present-day trade and is based on the principle that much of our commerce is built on credit and that credit implies risk. Accordingly, the most honorable merchant may be ruined without actually committing any crime. It is to relieve such an honest debtor from the load of his debt and to save him from going to an almshouse, as well as to distinguish between fraudulent bankruptcies and honest misfortunes, that bankruptcy legislation has been enacted. The purposes of present-day bankruptcy proceedings may be summarized as follows:

1. To establish judicially the insolvency of debtors.
2. To provide facilities for locating and collecting the debtor's assets, either upon his own request or that of his creditors.
3. To provide for the uniform administration of insolvent estates by taking such administration out of the hands of state courts.
4. To provide remedies and punishments to insure the orderly administration of the properties in accordance with the intention of the law.
5. To provide means whereby the debtor may, upon agreement of his creditors, retain his assets on payment of a certain agreed percentage of his indebtedness.
6. To effect a distribution of the bankrupt's assets equitably among the creditors.
7. To discharge debtors, if not guilty of fraud, from further

[2] BREWSTER, S. F., "Legal Aspects of Credit," p. 500.

legal obligations to their creditors, and thereby relieve them from the unbearable pressure of creditors.

Kinds of Bankruptcy.—Bankruptcy is divided into two main types: voluntary and involuntary. The fundamental distinction is that in the former instance the debtor himself requests the court to be adjudged a bankrupt, whereas in the latter case he supposedly is forced into bankruptcy by his creditors against his will. The word "supposedly" is used to indicate that proceedings which are technically and on the face involuntary may be practically voluntary. A debtor may, for example, acquaint several of his creditors with his financial condition, showing that he cannot continue in business even if extensions were granted. As soon as it becomes clear to his creditors that no other settlement is possible, they may advise the debtor to file a voluntary petition. Debtors frequently refuse to file a voluntary petition, one reason being that, in case of subsequent bankruptcy proceedings, no discharge could be secured if a discharge in voluntary bankruptcy had previously been granted within six years. These debtors, however, do consent and may be even anxious that creditors kindly disposed toward them file what is technically considered an involuntary petition.

In voluntary bankruptcy the debtor himself files a petition admitting his inability to meet his obligation by reason of his assets at a fair valuation being less than his liabilities, and expressing his willingness to be adjudged a bankrupt on that ground. The purposes of voluntarily going into bankruptcy are: first, to have the assets equally distributed among all creditors; and, second, to secure relief from further obligations, so as to be able to begin business anew and unencumbered.

Any one, regardless of the amount owing, may file a petition in bankruptcy, except municipal, railroad, insurance, and banking corporations. These four are obviously excepted on grounds of public policy. Should such institutions become insolvent, however, creditors may apply to a court of equity for the appointment of a receiver to take charge of the assets for their benefit.

Notwithstanding the absence of restrictions as to the amount that must be owed by a person who files a petition in bankruptcy, the practice is confined nevertheless only to large debtors, because of the expense of the proceedings.

To force a person or firm into bankruptcy involuntarily, a

petition must be filed by three or more creditors with provable claims amounting in the aggregate, in excess of collateral or securities held by them, to $500, or over. If the creditors are less than 12 in number, however, one creditor with a net provable claim of $500 or over may file the petition. In determining the number of creditors for this purpose, creditors who were employed by the bankrupt at time of filing the petition, or those related to him by blood or marriage within the third degree, are not included. The debtor must owe $1,000 or more at the time of filing the petition by creditors and must have committed one or more of the five acts of bankruptcy within four months of the date of filing the petition. The debtor must also be insolvent in the sense that the entire mass of his resources at a fair valuation falls short of satisfying his existing indebtedness.

Not every person or firm may be forced into involuntary bankruptcy by creditors. Wage earners, whose compensation does not exceed $1,500 a year, farmers, municipal, railroad, insurance, and banking corporations cannot, under any circumstances, be thrown into bankruptcy by creditors. Furthermore, it is necessary to prove that the debtor owes $1,000 or over, has committed one of the five acts of bankruptcy, and has resided in the judicial district in which the petition is filed over three months.

Acts of Bankruptcy.—The five acts of bankruptcy as set forth in Chapter III, Section 3, of the law consist of having:

1. Conveyed, transferred, concealed or removed or permitted to be concealed or removed any part of his property with intent to hinder, delay, or defraud his creditors, or any of them; or

2. Transferred, while insolvent, any portion of his property to one or more of his creditors with intent to prefer such creditors over his other creditors; or

3. Suffered or permitted, while insolvent, any creditor to obtain a preference through legal proceedings, and not having at least five days before a sale or final disposition of any property affected by such preference vacated or discharged such preference; or

4. Made a general assignment for the benefit of his creditors, or, being insolvent, applied for a receiver or trustee for his property or because of insolvency a receiver or trustee has been put in charge of his property under the laws of a State, or Territory, or of the United States; or

5. Admitted in writing his inability to pay his debts and his willingness to be adjudged a bankrupt on that ground.

Payment, while insolvent, of a preexisting debt constitutes sufficient evidence of the commission of the second act of bankruptcy. But payment of a debt which arises simultaneously with or after the payment does not constitute a preference. Thus, payment made for the purchase of merchandise on C. O. D. or "cash" terms does not result in a preference, since the effect of such transaction is not to diminish the insolvent's estate, but merely to substitute one asset for another, namely, merchandise for cash.

Not until the debtor commits one of these acts may the court adjudicate him bankrupt without his own consent. It is possible, however, to create one of these acts of bankruptcy or to cause the insolvent debtor to commit it. Thus, one creditor, with the approval of others who are desirous of placing the debtor in bankruptcy, brings suit for a claim, obtains judgment, and levies execution against the debtor's property. In this manner, the third act of bankruptcy is committed, thereby allowing the creditors to file their petition, for the result of suit and judgment is to secure a preference whose effect is to deplete the insolvent's estate for the benefit of one creditor and to the detriment of all others.

Bankruptcy Proceedings.—The various steps involved in the administration of a bankrupt's estate for the satisfaction of his creditors may be summarized in the following manner:

1. Petition is filed in the Federal district court.
2. A trial is held, the court adjudges the debtor a bankrupt, and refers the case to a referee in bankruptcy for administration.
3. Referee notifies creditors of the adjudication.
4. Creditors file proofs of claims with the referee.
5. A meeting of creditors is called by the referee.
6. Creditors elect a trustee for the purpose of handling the estate under the supervision of the referee, liquidating the assets and distributing the proceeds.
7. Bankrupt is examined by the creditors.
8. Trustee liquidates the estate and prorates the proceeds among the creditors by means of dividend declarations.
9. Trustee files the final accounts with the referee for his approval.
10. If approved, the final report is submitted to the court, where the discharge is granted.

Filing the Petition.—Irrespective of the kind of bankruptcy, proceedings are always begun by filing a petition in the Federal district court of the state or territory of which the debtor has been a resident over three months prior to filing the petition. The petition is a written document alleging the essential facts necessary to warrant the court in adjudicating the insolvent debtor a bankrupt. It is a prescribed legal form containing spaces for:

1. A statement of the creditors to be paid in full, because of priority secured by law.
2. A statement of creditors holding security.
3. A statement of unsecured claims.
4. A statement of liabilities.
5. A statement of assets, including realty, personalty, choses in action, and property held in trust.
6. A statement of property for which exemption is claimed.

After the truthfulness of the statements contained therein is verified by oath, the petition is filed with the clerk of the district court in which the debtor resides, and a fee of $30 is paid. Of this fee $15 goes to the referee, $10 to the clerk, and $5 to the trustee.

Trial.—As soon as the clerk makes the necessary entries, he submits the petition to the court and the alleged bankrupt is given a reasonable opportunity to deny the charges, if petition is filed by creditors. Thus, he may contend that he is not insolvent, that he has not committed any act in bankruptcy, that the allegations regarding the provable claims of the petitioning creditors are untrue, or that the court has no jurisdiction, and so on. The court hears the evidence on both sides and on that basis either dismisses the petition or adjudges the debtor a bankrupt.

If the bankrupt elects to contest the proceedings, a jury trial is necessary before the court can sign the decree adjudicating him a bankrupt. Usually, however, such suits are not contested, and at the expiration of about 20 days, which the bankrupt is given in which to appear and plead to the petition, the court either dismisses the petition or enters a decree adjudging him a bankrupt. Section 18, Chapter IV, of the Federal Bankruptcy Act provides that in case of involuntary proceedings the writ of subpoena served on the defendant must be returnable within 15 days, "unless the judge shall for cause fix for a longer time,"

and that the bankrupt or any creditor may appear and plead to the petition within five days after the return day, making a total of 20 days under normal conditions.

Referee in Bankruptcy.—If the petition is sustained by proof, the decree is signed adjudicating the insolvent debtor a bankrupt, and the case is turned over to a referee who is directed to proceed with the administration of the estate. The referee is an officer of the Federal court, appointed by the district judge for a term of two years. His duties are to supervise the administration of all bankrupt estates within his assigned territory, beginning as soon as the insolvent is adjudged a bankrupt and continuing until a discharge is granted. He must have such intimate relations with all the proceedings that the law provides for at least one referee in each county where such services are needed. Accordingly, no less than 48 referees are holding office at the present time in the four Federal bankruptcy districts of Ohio and as many as 41 in the state of New York.[3]

Powers of Referee.—According to Chapter V, Section 38, of the Federal Bankruptcy Act, referees are invested, subject to a review by the district judge, with the jurisdiction to:

1. Consider all petitions referred to them by the clerks of the Federal district court in the absence of the judge from the district, and either dismiss them after a hearing or make the adjudications.

2. Exercise the powers vested in courts of bankruptcy for the administering of oaths to and examination of witnesses and to require the production of documents in proceedings before them. They cannot, however, exercise the power of commitment.

3. In the absence of a judge from the judicial district or in case of his sickness or inability to act, as evidenced by a certificate issued by the clerk, to take possession and release the property of the bankrupt, whenever required.

4. Perform such part of the duties as are conferred by the act on courts of bankruptcy or prescribed by rules or orders of such courts in their respective districts. Referees may not, however, confirm compositions which may be proposed or act upon applications of bankrupts for discharge from further obligations.

5. During the proceedings, upon application of the trustee,

[3] "Credit Man's Diary," published by the National Association of Credit Men, 1923.

to authorize the employment of stenographic help, at the expense of the estate for reporting and transcribing the proceedings.

Duties of Referee.—The referee's duties are definitely prescribed in Chapter V, Section 39, of the act. His principal duties may be arranged as follows:

1. To give notice to creditors of the adjudication and of meetings.

2. To examine all schedules of property and lists of creditors filed by bankrupts. These schedules show all the assets of the estate and arrange all liabilities in the order of priority of claim, and constitute an index to the entire proceedings.

3. To prepare and file schedules in bankruptcy, if bankrupt neglects them. This, of course, applies only to involuntary proceedings, for in voluntary cases schedules must be ready to file with the petition, whereas in the former instance, schedules are filed within 10 days after the decree has been signed.

4. To declare dividends and prepare and deliver to trustees dividend sheets showing the amounts declared and to whom payable.

The other duties deal with the preservation and handling of all records of the proceedings, and the furnishing of information to all interested parties.

Compensation for his efforts is regulated by the law and consists of $15 deposited with the clerk when petition is filed, 25 cents for each proof of claim that is filed, and 1 per cent on all sums disbursed to creditors, or one-half of 1 per cent of such disbursements in case of a composition settlement.

Filing Proof of Claims.—Creditors should file their claims promptly upon receipt of notice of the adjudication or of the first creditors' meeting, since only those creditors whose claims have been allowed may participate in the selection of a trustee. Claims may be filed with the referee at or before the first meeting of creditors or thereafter within one year from adjudication. Subsequent to one year from such date, no claims can be proved against a bankrupt estate.

Claims are filed on certain forms which were adopted and prescribed by the Supreme Court of the United States in accordance with the provision in Chapter IV, Section 30, of the Bankruptcy Act. In these forms, a creditor sets forth his claim and the consideration therefor, payments made on the claim, and the amount justly owing from the bankrupt. If any securities

are held for the claim under consideration, that fact must be stated in the "proof of debt" form. It is advisable to attach itemized bills setting forth the nature of the claim. If a claim is based on a written instrument, such instrument must be filed with the claim. In event the instrument is lost or destroyed, a statement to that effect must be filed under oath with the claim.

In the event a creditor is unable to attend the creditors' meeting personally, he may be represented by an attorney, if he fills out the blank power of attorney incorporated in the "proof of debt" form and found on the reverse side. No special advantage, save that of convenience, can ordinarily be gained from such representation. On the other hand, there is a possibility of placing such claims in the hands of unscrupulous attorneys who are overanxious to secure a large number of claims in order to obtain control of the estate through the appointment of a trustee who is to represent *them* rather than the creditors. If not in a position to control the insolvent's estate, such attorneys may hold out in a composition settlement in order secretly to secure additional compensation for themselves from the debtor. For these reasons, some attorneys make it a practice to solicit claims against insolvent estates and offer to represent creditors without any fee. It is against such attorneys as these that creditors must be cautioned in the exercise of their power to authorize an attorney to represent them at creditors' meetings. It is unjust, however, for credit men to maintain a contemptuous attitude towards the commercial attorneys, as such, for relatively few of them are in the class of dishonest bankruptcy practitioners.

A much better practice in vogue at the present time is to file the claim with the referee and to give a representative committee of creditors or an adjustment bureau, where one is available, a proxy to vote at the meetings, or else assign the claim to the bureau, which will itself file it and take whatever action it deems advisable. In either case, the creditor may be certain that a more competent trustee will be elected and that the estate will be administered in a more businesslike fashion.

All debts owing at the time the petition is filed, though not payable until a later date, may be proved. Other provable debts consist in claims for torts reduced to judgment before the adjudication; claims of persons contingently liable for the bank-

rupt; and all liquidated claims of a contractual nature, such as breach of contract.

Meeting of Creditors.—The first duty of the referee is to notify every creditor of the adjudication and to call a creditors' meeting, which must be held not less than 10 nor more than 30 days after the decree of bankruptcy has been signed. According to paragraph (*a*), Section 58, Chapter VI, creditors are entitled to 10 days' notice by mail, unless they waive notice in writing. Such notice must be published at least once, not later than one week prior to the meeting. Not only must notice be sent of all meetings of creditors, for the same applies to all examinations of the bankrupt, all hearings for the confirmation of a composition, all proposed sales of property or compromises of any controversy, declaration and time of payment of dividends, the filing and examining of the final accounts of the trustee, and the proposed dismissal of the proceedings; creditors are also entitled to 30 days' notice of all applications for the discharge of bankrupts.

The purpose of the first meeting of creditors, at which the judge or referee presides, is to allow or disallow the claims of creditors there presented, to elect a trustee, and to place the debtor on the witness stand for an examination by the creditors personally or through their representatives.

Subsequent meetings may be called from time to time whenever the referee deems it necessary or whenever one-fourth or more in number of those who have proved their claims file a written request to that effect. Whenever the affairs of the estate are ready to be closed a final meeting of creditors must be ordered.

Allowance of Claims.—Ordinarily, before the first meeting of creditors, many claims will have been filed; others are filed at this meeting. If filed in proper form and in the class of provable claims, the next thing is to determine whether they shall be allowed. Generally, all provable claims are allowable. To this there are two important exceptions. Secured claims, for example, are allowable only to the extent of the difference between the amount of the claim and the value of the property securing the claim. Again, claims with voidable preferences will not be allowed till such preferences are surrendered. Furthermore, the trustee may avoid such a preference and recover the property or its value for the benefit of all creditors.

According to paragraph (*a*), Section 60, Chapter VI, of the Bankruptcy Act, a preference is voidable if, (1) given for a pre-

existing debt, (2) within four months before the filing of the petition, or after filing the petition and before the adjudication, and (3) if the person receiving it or benefiting thereby had reasonable cause to believe that the debtor was insolvent at the time and therefore apparently intended to give the recipient a preference. The purpose in making such preferences voidable is to enable the trustee to recover every payment made to creditors within four months prior to filing the petition or before adjudication, in order to provide for an equitable distribution of the insolvent estate.

The Trustee.—Just as the referee represents the court, so the trustee represents the creditors. The trustee is elected at the first meeting by those creditors whose claims have been proved and allowed. A majority vote, both in number and amount of claims, is necessary to effect such election. The election of the trustee is subject to the approval of the referee, and in event the creditors cannot agree on a trustee, as where the vote on the per dollar of claim basis conflicts with the per capita basis, the referee appoints one. Where there is a conflict in the results of the two votes, the choice of the majority of creditors is usually appointed by the referee.

Before entering upon his official duties, a trustee, in order to qualify for the position, must file a bond, the amount of which is determined by the vote of the creditors at their first meeting, but may be increased at any time thereafter as the creditors see fit. This in a measure indicates the importance of his position, for all creditors may administer the insolvent estate only through the medium of their trustee. Hence, to insure the largest possible dividends it is essential that a competent trustee be elected in order that the estate may be handled in an honest and business-like manner. It is urged, therefore, that all creditors be present or else properly represented at the first meeting, when such election takes place.

Following his appointment and qualification, the trustee takes title to all of the bankrupt's property as of date the debtor was adjudged a bankrupt, except in so far as exemption to the property is claimed and allowed. He is vested with the title of all documents relating to the bankrupt's assets; interests in all sorts of intangible assets, including patents, patent rights, copyrights, and trade-marks; property fraudulently transferred by the bankrupt to his creditors; and rights of action arising from contracts,

etc. In a word, the trustee practically stands "in the shoes" of the bankrupt as far as title to the property is concerned. He holds the property and may convey title to the purchaser thereof subject to all legal and equitable liens. He acquires no better title to the property than the bankrupt had.

Duties of the Trustee.—The duties of a trustee are outlined in paragraph (*a*), Section 47, Chapter V, of the Bankruptcy Act. He is required to reduce all property to possession, liquidate it under the direction of the court as expeditiously as compatible with the best interests of all parties concerned, deposit the proceeds received in one of the designated depositories, and distribute the moneys among the creditors as required by law. Real and personal property belonging to the bankrupt estate, after being properly appraised by three disinterested appraisers appointed by the court, is usually sold subject to the approval of the court, and the sale must be approved if the property realizes less than 75 per cent of its appraised value. He must account for all receipts and disbursements, furnish information concerning the estate to all parties in interest, lay before the final meeting of the creditors detailed statements of the administration of the estate, and make final reports and file final accounts with the court 15 days before the days fixed for the final meetings of the creditors.

Compensation of Trustee.—Compensation for his efforts is regulated by Section 48, Chapter V, of the law itself on a percentage basis, with the exception of the $5 which he receives out of the $30 fee deposited with the clerk when the petition is filed. In addition to this $5 his compensation must not exceed 6 per cent of the first $500 disbursed to creditors on claims allowed by the court, 4 per cent on that from $500 to $1,500, 2 per cent on that from $1,500 to $10,000, and 1 per cent on all sums in excess of $10,000. In event of a composition settlement, the trustee is entitled to only one-half of 1 per cent on all moneys disbursed to creditors.

Examination of the Bankrupt—One of the most important phases of the proceedings is to place the bankrupt on the witness stand, where he may be questioned personally by any *bona fide* creditor or through an attorney or other representative of creditors, with a view to ascertaining and establishing the fraud or preference of which the creditors may be suspicious. To make such an examination possible, Section 7, Chapter III, of the

Bankruptcy Act, provides that the bankrupt shall submit to an examination concerning the conduct of his business and all matters directly relating to the cause of his bankruptcy, his dealings with his creditors and other persons, the whereabouts of his property, as well as all matters which may affect the administration and settlement of his estate. This testimony, however, may not be used against him in any criminal proceeding.

The other well-defined duties which devolve upon the bankrupt are: to attend the first meeting of his creditors, if so directed by the court, and also the hearing upon his petition for a discharge, if filed; to comply with all lawful orders of the court, to examine the correctness of proofs of claims against his estate; to cooperate with the trustee in collecting and protecting the assets; and to prepare and file schedules showing (1) the amount, kind, value, and whereabouts of his property; (2) a list of creditors; and (3) his liabilities and securities held by creditors, if any.

Should the bankrupt, upon examination, prove hostile or otherwise unsatisfactory, because of his evasive replies; or should he refuse to answer questions or to produce records; or should he otherwise manifest a desire to withhold necessary and helpful information, the court may confine him for contempt of court. He is also subject to arrest if he refuses to appear for examination when so ordered or when satisfactory proof by affidavits is given that the bankrupt intends to leave the district in order to avoid examination or otherwise defeat the proceedings in bankruptcy. For under such circumstances the judge is given power to issue a warrant to the marshal directing him to bring the bankrupt before the court for examination any time after the filing of the petition and before the expiration of one month following the qualification of the trustee. When so confined, the bankrupt may be kept in custody not exceeding 10 days.

Declaration and Payment of Dividends.—Before any dividends may be declared and paid on the allowed claims of general creditors, certain debts having priority must be paid in full out of the bankrupt estate. The following debts are given priority by Section 64, Chapter VII, of the Bankruptcy Act, in the order in which they are listed herewith:

1. All taxes due to the United States, the state, county, district, or municipality.

2. The actual and necessary cost of preserving the estate subsequent to filing the petition.

3. The filing fees paid by creditors in involuntary proceedings, and the reasonable expenses of recovering transferred and concealed property.

4 The cost of administration, including fees and mileage payable to witnesses, and one reasonable attorney's fees for services actually rendered to the petitioning creditors in involuntary cases, and to the bankrupt in voluntary cases, as the court may allow.

5. Wages due to workmen or other employees which have been earned within three months prior to the date of the commencement of proceedings, not exceeding $300 to each claimant.

6. Debts owing to any person who by the laws of the United States is entitled to priority.

After the above claims have been paid in full, the remainder is distributed pro rata among all other creditors. In this connection it should be observed that a judgment creditor has no priority over other unsecured creditors unless an execution has been levied on specific property at least four months prior to the filing of the petition.

As already indicated in a previous connection, the referee must declare dividends and prepare dividend sheets showing dividends declared and to whom payable. It then devolves upon the trustee to pay the dividends thus declared within 10 days after the declaration by the referee. Section 65, Chapter VII, of the act provides that the first dividend must be declared within 30 days after the adjudication, if the money of the estate in excess of the amount necessary to pay in full all prior and lien claims amounts to 5 per cent or more of the allowed claims. Not more than 50 per cent of the funds on hand in excess of the amount needed to satisfy prior and lien claims may be paid out on the first dividend. Subsequent dividends must be declared whenever the amount to be distributed equals 10 per cent or more, as well as upon closing of the estate. Dividends may be declared oftener and in smaller proportions upon the order of the judge. The final dividend, however, is not to be declared within three months after the first dividend has been declared. All dividends which remain unclaimed for six months after the declaration of the final dividend are to be paid by the trustee into the court. If unclaimed for a period of one year, the judge may direct that such dividends be distributed among creditors whose claims have been allowed but not paid in full, the balance,

if any, going to the bankrupt. Unclaimed dividends belonging to minors must remain intact until one year after such minors arrive at majority.

Settlement by Composition.—It has already been brought out in another chapter that a composition at common law is a contract entered into by an insolvent debtor and all of his creditors, whereby the debtor settles the claims against him at an agreed percentage of their face value, provided the creditors mutually promise to release him from the balance of his indebtedness. Compositions in bankruptcy are not the result of a contract but take effect by operation of the law. Unlike those of the former type, the terms of the offer of compositions in bankruptcy may be confirmed by the court and the settlement made binding upon every creditor in the absence of fraud if such compositions are agreed to by a majority of the creditors controlling more than half of the total indebtedness. By virtue of such a composition, the proceedings are terminated and the title to the estate is revested in the bankrupt, who thereupon secures a discharge from his indebtedness.

Every creditor knows that litigation is expensive. He is therefore anxious to accept a proposal to settle at so many cents on the dollar if the bankrupt is honest and can secure financial assistance from outside sources. Such a settlement is made possible by Chapter III, Section 12, of the Bankruptcy Act, which provides that the debtor may, either before or after adjudication, offer terms of composition to his creditors after, but not before, he has been examined in open court or at a meeting of his creditors, and has filed in court the schedule of his assets and a list of his creditors. After the composition has been accepted in writing by a majority, in number and amount, of all creditors whose claims have been allowed, and the consideration to be paid by the bankrupt to his creditors including the money necessary to pay in full all prior claims and the costs of the proceedings have been deposited in a place designated by the judge, an application for its confirmation may be filed in the court of bankruptcy.

The judge thereupon confirms the composition, if he is satisfied that (1) it is for the best interests of the creditors, (2) the bankrupt has not been guilty of fraud, (3) the bankrupt has not been previously discharged in voluntary proceedings within

six years, thereby barring his discharge, and (4) the composition is offered and accepted in good faith.

If the composition is confirmed, the court appoints a distributing agent, who is ordinarily either the referee or trustee, who distributes the composition fund and makes a report to the court.

Any creditor may oppose the composition by filing with the court written objections setting forth the grounds on which such opposition is based. To be considered, such objections must be filed prior to the confirmation of the proposed settlement. Should these grounds prove adequate, the judge may refuse to approve the settlement, even though agreed to by the requisite number of creditors. If a creditor thinks that the amount offered is too small, he may offer to take over the property himself and pay the other creditors a higher dividend. Usually, the effect of such a position, where a creditor stands ready to pay a larger sum for the property because of its real higher value, is to cause the bankrupt to offer a higher dividend in order to regain possession of his assets.

Another important feature is that any creditor who discovers that another creditor who was a party to a composition by agreement with the debtor received more than his *pro rata* share may disregard the release he gave and bring suit for the unpaid balance of his original claim, for such a preference is fraudulent as to those creditors who were ignorant of it.

Discharge of Bankrupt.—One of the main purposes of bankruptcy laws is to enable creditors to take possession of an insolvent debtor's assets and equitably distribute their proceeds among themselves. The second chief object of the law is to release the bankrupt debtor, through a discharge, from his unpaid liabilities, thereby allowing him to start anew and unencumbered. In accordance with this object, Section 14, Chapter III, provides that a debtor may, after the expiration of one month and within the next 12 months subsequent to being adjudged a bankrupt, file an application to the court of bankruptcy for a discharge. Time for filing the application may be extended by the judge not more than six months.

All creditors must be notified 30 days prior to the hearings upon applications for discharge. This gives all interested parties a reasonable opportunity to be sufficiently heard. Any creditor who intends to oppose a discharge must file with the clerk a

sworn statement on a prescribed form setting forth his reasons for the opposition.

After hearing the application for a discharge and proofs and pleas in opposition thereto, the court will grant the discharge unless the bankrupt has committed one of the acts expressly prohibited by paragraph (*b*), Section 14, Chapter III, of the Bankruptcy Act. According to this section a discharge shall not be granted if the bankrupt has:

1. Committed an offense punishable by imprisonment, as provided by the act, such as concealing property from the trustee, making a false oath or account in bankruptcy proceedings, or presenting under oath a false claim against his estate.

2. With intent to conceal his financial condition, destroyed, removed, or failed to keep books of account or records from which such condition might be ascertained.

3. Obtained money or property on credit upon a materially false statement in writing.

4. Transferred, removed, destroyed, or concealed, or permitted to be removed, destroyed, or concealed, any of his property with intent to hinder, delay, or defraud his creditors, within four months immediately preceding the filing of the petition.

5. In voluntary proceedings, been granted a discharge in bankruptcy within six years. It is, therefore, advisable from the creditors' standpoint, to persuade the debtor, wherever possible, to file his own petition and go into bankruptcy voluntarily, thereby preventing a recurrence of purposeful bankruptcy within the next six years.

6. In the course of the proceedings in bankruptcy, refused to obey any lawful order of, or to answer any material question approved by, the court.

If there has been any fraud in bringing about the proceedings, or in concealing property which should have been surrendered for the benefit of creditors, any of the defrauded creditors may apply to the court within a year after the discharge has been granted and have it revoked. It must be proved that knowledge of the fraud has been acquired by the petitioners since the granting of the discharge, and had such facts been known in time, the discharge would not have been granted. It, therefore, behooves insolvent debtors to be honest in their dealings with creditors, particularly in bankruptcy proceedings.

Debts Not Affected by Discharge.—Chapter III, Section 17. of the Bankruptcy Act provides that a discharge in bankruptcy releases the bankrupt from all of his provable debts incurred before the petition was filed, except the following debts, which remain a claim against him even after a discharge in bankruptcy has been granted:

1. Taxes levied by the United States, the state, county, district, or municipality in which he resides.

2. Liabilities for obtaining property by false pretenses or false representations, or liabilities for certain civil injuries, including alimony due or to become due, or for maintenance or support of wife or child, or for the seduction of an unmarried female, or for breach of promise of marriage, or for criminal conversation.

3. Unscheduled claims unless creditor had notice or actual knowledge of the proceedings in bankruptcy.

4. Debts created by the bankrupt's fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity.

5. Wages earned by employees within three months prior to date of commencement of proceedings in bankruptcy.

6. Moneys received from an employee to secure the faithful performance of such employee in accordance with the terms of the contract.

To the above may be added all debts incurred after the petition has been filed. All creditors whose claims fall in any of the above groups may proceed with the enforcement of collection as if no bankruptcy proceedings had taken place.

Weaknesses of the Law.—Many objections to the law and its administration may be heard on all sides. One of the fundamental weaknesses of the law lies in the definition of bankruptcy. To come within the provisions of the act, a person, to be insolvent, must have property which at a fair valuation is insufficient in amount to meet his debts. Thus a person may be ordinarily insolvent in the sense that he is not able to meet his obligations as they mature without the necessity for disposing of the general mass of his assets, current as well as fixed, and yet he may not petition himself or be petitioned without his consent, into bankruptcy. If solvency is proved by the alleged bankrupt, the case is dismissed and the petitioning creditors must bear all the expenses involved, including attorneys' fees of the defendant.

Another fundamental objection is that the burden of proof of

insolvency or fraud is imposed upon the creditors. Thus, it is frequently necessary to prove intent on the part of the insolvent debtor to defraud before any satisfaction may be obtained. Among the other objections is that the cost of administration of insolvent estates is too high; that the dividends paid by many bankrupt estates are too small; that the machinery is clumsy and leaves much to be desired in the way of honest and business-like administration of bankrupt estates.

Recognizing the fact that "bankruptcy rings" exist in many districts and that they exact exorbitant and unwarranted fees, etc., several important recommendations were made in a report of the federal judiciary conference for improvement of bankruptcy administration held March, 1924, in Philadelphia at the suggestion of Chief Justice Taft. The conference was made up of members of the federal judicial council, American Bar Association, Commercial Law League of America, and the National Association of Credit Men. It was discovered that not only were exorbitant fees exacted by these so-called "bankruptcy rings" but that they were attempting to control estates secretly in the interest of the bankrupts themselves, to encourage and control unfair composition settlements, to file petitions on fictitious assigned claims, and to defeat generally the fundamental purposes of the Federal Bankruptcy Act.

As a result of this conference several general orders were recommended as additions to those already in force in the administration of bankrupt estates. Among them were the following:

"That the referee, at the time of closing an estate in which there were assets, should mail each creditor whose claim has been allowed, a summarized statement of all money received and disbursed in the proceedings.

"That no receiver or his attorney shall solicit any authority to represent any creditor in connection with the administration of the bankrupt's estate.

"That no allowances from the bankrupt estate shall be made for the service of receivers, trustees or attorneys, except at a hearing of which all creditors shall have 10 days' notice in writing.

"That the court shall have power to deny allowance of a fee to the attorney for petitioning creditors whenever it shall appear that the proceedings were not instituted in good faith."

Another objection recently raised by the National Association of Credit Men is against the decision handed down by the United States Supreme Court on May 21, 1923, in *McCarthy vs. Arndstein* to the effect that "an ordinary witness . . . is not deprived (by the Bankruptcy Act) of the privilege in stopping short in his testimony whenever it may fairly tend to incriminate him." The case was carried to the Supreme Court after Arndstein refused to answer questions in a bankruptcy examination regarding his assets on the ground that answers to the questions asked would tend to incriminate him. Arndstein was adjudged to be in contempt of court because of his refusal to answer questions during the examination. He then asked the district court for a writ of *habeas corpus,* and when the writ was refused, he appealed to the United States Supreme Court where the above decision was handed down.

Realizing the detrimental effect of such a decision, the National Association of Credit Men was permitted, upon its request, to file a brief as *amicus curiæ,* in the United States Supreme Court, on a petition for a rehearing or for a modification of the opinion in the Arndstein case, contending that such decision is contrary to the previous decisions of the United States Supreme Court in *Dier vs. Banton* decided May 7, 1923, and in the Fuller case decided April 30, 1923, if carried out to the logical conclusion, and that it is also contrary to the common law which existed prior to the fifth amendment to the Constitution, providing that "a bankrupt cannot refuse to discover his assets and effects, though . . . that information may tend to show he has property which he has not got according to law."[4]

Notwithstanding all the weaknesses herein enumerated, it is believed nevertheless that most of the unsatisfactory results obtained under the law are due in large measure, if not entirely, to the lack of interest and attention on the part of creditors. The small dividends paid are due partly to the failure of creditors to attend creditors' meetings, to insist upon a thorough examination of the bankrupt before accepting an offer in a composition settlement, and unwillingness to cooperate with other creditors properly; and partly because of the habit of acting through the medium of dishonest bankruptcy practitioners. With this in

[4] MONTGOMERY, W. R., "Withholding His Books," *The Credit Monthly,* Nov., 1923.

mind, the National Association of Credit Men published in its "Credit Man's Manual" for 1923 the following ten points:

1. The bankruptcy court is a creditors' court, and the credit man who fails to interest himself in its administration is costing his house money.
2. For every crooked bankrupt, there are likely to be two crooked lawyers, one representing the bankrupt, the other soliciting your claim —in the interest of a crooked settlement.
3. Creditors who want honest administration must wake up their sleeping brothers. Solicit their claims yourself. Don't leave it to someone who may be in collusion with the bankrupt.
4. Beware of compositions. You have a right to the facts and figures. Don't sign until you know.
5. A bankrupt who refuses to answer questions has something to conceal.
6. Know who filed the petition. Sometimes the "three creditors" (so-called) are dummies representing the bankrupt.
7. A superficial examination of the bankrupt is worse than none. It is often used to whitewash a black record.
8. Examine the schedules and beware of bogus benefactors. Rich and benevolent relatives file large claims for small advances.
9. Receivers with good intentions have dissipated many an estate. Elect a business trustee and see that he does his job, and elect him early.
10. Take nothing for granted.

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CHAPTER XXVII

CREDIT INSURANCE

Nature of Credit Insurance.—The basic principle underlying this particular phase of insurance is identical with that upon which all kinds of insurance are founded. It merely involves an application of the law of averages to losses incurred in the form of bad debts. The contract entered into by the insured with the company constitutes the credit insurance policy, variously styled the bond of indemnity, or the contract of guarantee on insolvent debtors' accounts. A credit insurance policy is a guaranty that the policy holder shall not suffer those losses, occurring because of uncollectible accounts coming within the coverage of the policy, which exceed the normal loss incident to the particular business of the insured. It protects the insured only against extraordinary losses, the normal loss, or, as it is frequently styled, the initial loss, being borne by the insured, probably on the theory that the insurance company could not undertake insurance against such annual loss for a premium smaller than the yearly *expected* loss. Hence, only payment of the net excess over the normal, initial, or "own" loss may be guaranteed by the insurance company. For this reason, credit insurance may be defined as an application of the principle of indemnification for *excessive* or unanticipated losses arising from bad debts.

Development.—Of the three companies writing practically all of the domestic credit insurance, the American Credit Indemnity Company of New York confines its business exclusively to this type of insurance. The other two companies write multiple lines. They are the Ocean, Accident and Guarantee Corporation, Ltd., and the London Guarantee and Accident Company, Ltd. The first of the three companies was incorporated in the state of New York as early as 1893. The other two organizations established credit insurance departments in the United States in 1895 and 1905, respectively.[1]

[1] *The Bankers' Magazine*, Sept., 1922, vol. 105, no. 3, p. 518.

Prior to the passage of the national Bankruptcy Act in 1898, credit insurance business was in the experimental stage and only restricted policies were written at relatively low premium rates. Beginning with that year, however, policies were liberalized from time to time so as to include all sorts of insolvency, and, finally, unlimited policies were introduced in 1916.

In insuring against a given contingency, the degree of risk must be determined by past experience with respect to the average outcome of numerous similar cases handled over an extended period of time. Obviously, the accuracy with which the risk may be determined varies directly with the amount of data available regarding similar contingencies in the past, and the more accurate and scientific the computation of the risk the less, within certain limits, the cost of insurance. To determine scientifically the degree of risk involved in a proposed extension of credit, it would be necessary to resort to a compilation of records covering failures of commercial houses, the causes therefor, and the financial condition of such concerns sometime prior to failure. Only from such records carefully kept over a period of years is it possible for credit insurance companies to determine with reasonable accuracy the extent of the risk involved in a given credit transaction. Since such statistics were not available in the past, the cost of credit insurance was based largely on mere guesswork. Consequently, premiums were made sufficiently high to cover the insurance company's loss in case it guessed wrong.

Credit insurance underwriting is no longer a matter of judgment for the individual underwriter, for one of the most outstanding developments has been the recent adoption of a mortality table by the three companies who do practically the entire business in this field. The "Manual of Credit Insurance Rates," or mortality table, was completed about two years ago. It consists of the results of a long succession of mathematical calculations based on the experience of the three organizations as revealed by their records. These records extend over a period of years, and show the precise experience of a large number of manufacturers and jobbers representing various lines of trade, giving their sales to concerns with various ratings, and the losses incurred because of insolvency of the debtors. The adoption of the manual containing the statistical compilations of actual cases constitutes an epochal event in this particular field of endeavor; it places credit insurance on a scientific basis whereby premiums

could be closely adjusted to a given risk, and obviates the necessity for main reliance on the judgment of individual underwriters. Moreover, the adoption of actuarial bases for underwriting against losses facilitates the training and development of agents in large numbers, thereby rendering possible a corresponding increase in the use of credit insurance.

Present Status.—Credit insurance policies are not issued to retailers; they are limited to manufacturers and wholesalers. Policies are carried by concerns of all sizes, varying from those with a volume of sales amounting to $50,000 a year to companies with an annual sales volume of $75,000,000. Medium-sized houses, however, constitute the majority of policy holders.[2]

All but a few lines of business are solicited by credit insurance companies. Certain lines of trade are considered too hazardous because of the nature of the goods handled, the flexibility of terms of sale, or the type of persons engaged in them. In the jewelry trade, for example, an average retailer may purchase diamonds on terms of about eight months, and if he has not succeeded in disposing of them by that time, the credit period may be considerably extended. Other lines considered extra hazardous include furs, patent medicines, jobbers of woolens, and scrap iron.

Term of Policy.—Credit insurance policies are generally issued for a period of one year. Some policies are written for a longer period when it is desired that they expire on the date which marks the expiration of the fiscal year of the insured. Since in most concerns the fiscal year coincides with the calendar year, a vast number of policies are written to expire on December 31. It is definitely stipulated that all losses to be covered by the policy shall occur during its term. Furthermore, such losses must result from shipments of goods made during the term of the policy.

Policies are renewable annually, and may be so arranged as to cover losses occurring during the life of the renewal arising from sales made during the term of the preceding policy, as well as the losses occurring during its term on shipments made thereunder. If the insured becomes insolvent during the term of the policy, ceases to continue business as previously carried on, or goes into liquidation, the policy terminates immediately and adjustments are then made in the same manner as if the policy had

[2] *The Bankers' Magazine*, Sept., 1922, vol. 105, no. 3, p. 519.

by its terms been made originally to expire at the date of such termination.

Types of Policies.—Two main types of policies are being issued, one known as the "limited," and the other the "unlimited." Policies are also differentiated on whether or not they contain a provision for collection of past-due accounts by the insurance company.

The "limited" policy is one having a face value which constitutes the maximum total liability of the insurer. For example, if the policy has a face value of $50,000 and the insured sustains losses aggregating $75,000, he is protected only to the maximum of the face value of the policy even though all the losses were within conservative limits and otherwise covered by the provisions of the insuring agreement.

The "unlimited" policy makes no provision for a maximum total liability of the insurer on the aggregate of accounts covered. All losses will be indemnified for under this policy as long as the individual accounts under which they were sustained come within the provisions of the policy with regard to ratings and maximum amounts specified therein.

As implied above, some policies provide that all accounts, in order to be covered, should be placed in the hands of the insurer for collection within a specified time after they become due, usually before they are more than 75 days past due under the original terms of sale. Other policies make such action elective with the insured. Because of this privilege these policies are frequently styled "optional."

Insolvency for Purposes of Policy.—Credit insurance policies guarantee indemnity against losses occurring because of insolvency of debtors. All policies are alike in what they stipulate to be the earmarks of insolvency, with the exception of the first definition. This varies with the nature of the policy. Optional policies stipulate that when the indemnified elects to file with the company, for collection, an account which is not over 60 days past due under the original terms of sale, the debtor whose account is thus filed is deemed insolvent. Where the filing of an account with the insurance company is not optional, in order to come within the first definition of insolvency, it must be filed before it is over 75 days past due under the original terms of sale. The other definitions of insolvency are fairly

standardized, and appear in practically all credit insurance policies. Thus a debtor is also deemed insolvent:

1. When a petition in bankruptcy or insolvency is filed by or against a debtor under the laws of the United States, or any State or Territory thereof, or of Canada;
2. When a debtor makes an offer of a general compromise to his creditors for less than his indebtedness;
3. When a receiver is appointed for a debtor;
4. In case of the death or insanity of a sole debtor;
5. In case of the recording of or taking possession under a chattel mortgage given by a debtor of his stock in trade to a creditor or creditors;
6. When an attachment or execution is levied on a debtor's stock in trade;
7. When a writ of attachment or execution against a debtor is returned unsatisfied;
8. When a debtor transfers or sells out his stock in trade in bulk;
9. When a debtor absconds;
10. When a debtor makes an assignment, or a deed of trust, for the benefit of his creditors, either general or with preference;
11. When the stock in trade of a debtor is sold under a writ of attachment or execution;
12. When a confession of judgment is made by a debtor;
13. When a debtor's business is assigned to or taken over by a committee appointed by a majority, in number and amount, of his creditors.[3]

The Normal Loss.—In all credit insurance underwriting there are three basic factors, namely: (1) the normal loss; (2) coverage; and (3) the premium. All of them are necessarily interdependent. The premium, for example, cannot be determined until coverage on each of the ratings specified in the table of ratings under the "coverage" clause of the policy is first ascertained, or until the normal loss is finally agreed upon.

The normal loss ratio is largely determined by the policy of a concern in dealing with its past-due accounts; also upon the number or volume of such accounts. This, in turn, varies according to the usual terms of sale. As a rule, the longer the period involved in credit extensions the larger the amount of outstandings carried on the books; consequently, the larger the sum tied up in past-due accounts. Given two houses of substantial similarity with respect to size, line of business, conditions of opera-

[3] From definitions of insolvency under "Conditions and Stipulations" of credit insurance policies.

tion, and terms of sale, the one which adopts a stricter and more effective policy toward its past-due accounts will invariably have a smaller normal loss ratio.

The normal loss is that amount which is *normally* lost in a particular line of trade because of bad debts. It is always expressed in a percentage of net sales, and varies in amount from a small fraction of 1 per cent for some lines to slightly over 1 per cent in others. The amount normally lost is calculable and is considered an expense item similar to other items of manufacturing and selling cost. When the policy holder bears his normal loss himself, his insurance premium is reduced by a considerable sum. When contrasted with fire insurance, it is argued, that if the average fire loss is 1 per cent of the value insured, the policy holder must pay in premiums not less than that amount for protection against fire, in addition to an amount sufficient to cover a proportional share of overhead and profit of the insurance company; on the other hand, if the average credit loss on sales is 1 per cent and the insured loses less than that amount during the term of the policy, he retains the difference between his actual loss and this average loss, since he does not pay the insurer any part of his normal loss. This is equivalent to saying that savings may be effected by carrying own insurance against normal losses. To ascertain the amount of the normal, or initial, loss to be borne by the insured, the net losses for several years back are compared with the volume of sales for each of these years. In this manner the average percentage of loss from year to year is determined. Thus if the sales for the past five years averaged $2,000,000 and the losses during the same period averaged one-half of 1 per cent, the normal loss to be borne by the insured is fixed at $10,000.

A second method of ascertaining the initial loss consists in dividing the total losses from bad debts over a period of five years by five, and the quotient taken as the normal loss.

A third plan provides for the determination of the normal loss at the expiration of the policy. Under this plan, the loss experience of the insured during the term of the policy is added to that of the preceding five years. Where the initial loss is thus determined, experiences extending over a period of six years are substituted for those of five.

Coverage. –All credit insurance policies definitely stipulate the maximum amount which the insured may recover for losses

on any one account to which he sells. This amount is definitely specified, in dollars, in the policy itself on the basis of the capital and credit rating which the account has. A maximum amount designated for any one rating applies to each and every account of that rating to which the insured sells. Much freedom is allowed the insured in the choice of the mercantile agency whose ratings should govern the shipments under the policy. Although any well-known agency is acceptable, nevertheless the R. G. Dun & Company and the Bradstreet Company are the two agencies most used for the purpose. The mercantile agency whose ratings shall govern, as agreed upon by both parties when the policy is written, is then specified in the policy. Gross amounts to be covered on any one debtor are then limited to the amount specified opposite the corresponding rating of the debtor in the "table of ratings" of said policy.

If a debtor has more than one governing rating, the maximum indebtedness covered is limited to the sum set opposite the highest governing rating, unless the high rating has been reduced. In case the latter is true, the reduced rating governs. It is to be construed that ratings of the latest published book of the mercantile agency chosen govern, except where reduced in a special agency report. If the name of a debtor does not appear in the latest published rating book, the shipment to the debtor is governed by the rating appearing in the latest agency report if compiled within four months prior to date of shipment; otherwise the shipment is governed by the rating appearing in the first report of the agency compiled within four months after the shipment.

Coinsurance.—One of the fundamental features contained in a credit insurance policy consists in the coinsurance requirements. Policy holders are required to coinsure or to bear part of the risk, even on the best risks. Thus, the amount insured against losses from well-rated and preferred debtors may be limited to about 25 or 30 per cent of the lowest capital rating assigned the debtor by the mercantile agency chosen for the purpose. Besides, the maximum provable loss on any one account may be limited to some definite sum or to a definite percentage of the face amount of the policy. For instance, even on well-rated risks, the insurer is liable only to the extent of $900 on an actual loss of $1,000, although the full amount otherwise comes within the terms of the contract, the policy holder being required

to bear part of the risk to the extent of the remaining $100. The purpose of coinsurance in general applying to all risks is to reduce thereby the moral hazard of taking unreasonable risks in the extension of credit, the company guaranteeing only an amount approximating, on the average, the replacement value of the goods, the aim being to cause the insured to lose his profit on the transaction, before any losses are paid by the insurance company.

Credit insurance does not protect the insured against losses sustained because of the insolvency of debtors who are "off-rated." "Off-rated" accounts differ from those which are classified by the agencies as "rated," in that the latter consist of accounts having a capital rating followed by a first- or second-class credit rating; whereas the former consist of accounts which have a lower credit rating than the latter, or possess no rating whatever. According to statistical evidences, the heaviest losses are sustained from accounts which are off-rated. Accordingly, on such inferior credit risks, when covered by a special rider requiring payment of a much larger premium, the insurance company limits its liability to about two-thirds the amount involved.

The Insurance Premium.—There are two principal practices with respect to the determination of the premium to be paid by the insured for the risk underwritten by the insurer. On some policies the entire premium is determined and paid in advance, while others stipulate that the premium be a specified percentage of the total gross shipments and deliveries made by the insured during the term of the policy, but such sum can be no less than a stipulated minimum. The minimum is payable in advance, while the remainder, if any, is paid at the termination of the policy when the amount can be definitely ascertained. The theory on which such premium is apparently based is that losses usually vary directly, though not proportionally, with sales. Since it is frequently impossible to predetermine with a fair degree of accuracy the gross sales for a whole year, the premium is likely to be inexact, unless it is based on the actual experience of the insured during the time the policy is in force. The chief disadvantage, however, of leaving the determination of the premium to the end of the year is the inability of the policy holder to determine the cost of the contract in advance.

Under all circumstances the size of the premium varies with the degree of hazard involved, and is determined after a careful

consideration of a number of factors. The factors upon which the calculation is based are the following:

1. The statements made in the application for insurance on the reverse side of the policy. They generally include the line and nature of the business and how long in it; territory covered; customary and longest terms of sale, including discounts allowed; distribution of shipments among manufacturers, jobbers, and retailers; detrimental information possessed on any doubtful accounts sold or to be sold; contemplated changes in the manner of doing business, terms of sale, radii of operation; gross annual sales and bad debt losses over the preceding five or six years; and condition of accounts outstanding at time the policy is written.
2. The maximum coverage for individual debtors.
3. Whether there is a provision for the inclusion of inferior ratings.
4. Whether there is a provision for the adjustment of the premium on the basis of gross sales.
5. The amount of coinsurance.
6. The term of the policy and its face value, if limited.
7. Other special riders and indorsements.
8. The efficiency of the credit and collection department.

As already pointed out in a previous connection, credit insurance companies have succeeded, after a long succession of painstaking mathematical calculations, in evolving a manual containing fixed schedules of rates for various lines of business. These tables correspond to the mortality tables of life insurance companies and are used in a similar manner. Premium rates are then determined only after a careful consideration of the factors hereinbefore enumerated, most of which are inserted in the application for insurance on the reverse side of the policy, followed by a consultation of the "Manual of Credit Insurance Rates."

Notification of Claims.—All losses covered by credit insurance must be proved. This is accomplished by sending to the insurance company notification of past-due accounts in accordance with the "notification of claim" condition of the policy. For this purpose, the insured may elect, under the optional collection form, to have the debtor deemed insolvent for the purpose of the policy, by sending the account to the insurance company for collection within 60 days from the time it became

due. Under another form of policy, past-due accounts must be turned over to the insurer for collection within 75 days from date of maturity. In any event, the insured is expected to make every practicable effort to collect the account or as large a portion as possible. Amounts thus collected thereon are considered salvage and deducted from the allowed loss. If a loss occurs because of the debtor's insolvency under the other definitions of the term it is necessary to file a notification of claim within a specified time, usually 15 days, after knowledge of the insolvency has been acquired, and the account must be placed in the hands of the insurer for collection.

When claims are filed with the insurance company, they must be accompanied by an itemized statement of the account showing its true condition, and all papers and documents relating thereto. Further information and papers, such as invoices, proofs of debt, and affidavits, must also be furnished upon request. When the insurance company is charged with collecting bad accounts, a charge is made for the service in accordance with a schedule of fees contained in the policy and all amounts collected are immediately remitted to the insured, except where certain sums have been collected from debtors who are deemed insolvent under definitions 2 and 14, inclusive, of the policy. These sums are generally retained by the insurers and the entire amount of the debt is considered a loss.

Policies requiring the insured to turn over their past-due accounts to the insurance company for collection have been objected to on the ground that in its collection efforts the company is likely to consider its own interests to the exclusion of the interests of the debtor and the insured. Creditors frequently consider it advantageous to accept a settlement which may net them immediately a substantially less than what could be obtained through bankruptcy proceedings. If the debtor is honest and deserving, creditors would probably be satisfied with a smaller sum, in the anticipation of ultimately recovering even more than the losses incurred through the continuance of friendly relations as soon as the embarrassed debtor is extricated from his difficulties and his business is soundly rehabilitated. Not so with the insurance company. Its only concern is the immediate settlement of the account and the collection of the largest sum possible, even though it becomes necessary to force the debtor into bankruptcy in order to obtain it.

The collection provision referred to in the preceding paragraph operates during the term of the policy. In the absence of such condition, it is provided that, where a claim is made for payment of losses in excess of the normal loss, a final statement of such claim be filed by the insured with the insurer not later than 30 days after the expiration of the policy. An adjuster is thereupon sent to the insured to effect an adjustment. By a special rider it is possible to provide for interim adjustments of claims, in which case loss payments are made to the insured during the life of the policy upon filing with the company interim statements when such losses occur. After the expiration of the policy, a final statement is filed, including any additional losses occurring under the policy when matters are finally adjusted.

Adjustments.—Adjustments are usually made within 45 days from the date the final statement of claim is received by the insurance company, and the amount due becomes payable at once. To ascertain the net allowed loss, the following deductions must be made from the gross loss covered and proved:

1. All discounts to which the debtor would have been entitled had the debt been paid at the date of insolvency.

2. All amounts collected on the account and all sums which may have been obtained from any other source.

3. Amount of goods returned or replevined, if in the undisputed possession of the insured.

4. All amounts mutually agreed upon as thereafter obtainable. If no satisfactory mutual agreement can be reached as to the amount thereafter obtainable, the insurance company must allow as much of the total unpaid sum as covered by the policy. All accounts admitted in adjustment must be assigned to the insurance company, except those upon which a mutual agreement has been reached as to the amount obtainable after the adjustment. If the company collects eventually from the accounts thus assigned more than the aggregate sum paid the insured, the net excess must be refunded.

5. The amount of coinsurance agreed upon in the insuring clause of the policy. In the main, there are two practices regarding the place where coinsurance is deducted. Under some policies it is not deducted until after the actual loss has been ascertained, whereas under other policies coinsurance is deducted from the gross loss covered and proved.

6. The normal loss.

To illustrate clearly the method of procedure in making adjustment of claims for payment of losses under a credit insurance policy, it may be assumed that the normal loss of the insured as fixed on the basis of his average losses over the past five years is $7,000, and that the face value of the policy is $10,000. It may be further assumed that the maximum loss on any single account covered by the policy is limited to 30 per cent of the lowest capital rating, if the account is rated in the first credit grade, or 25 per cent of the lowest capital rating, if rated in the second credit grade. The insurance company is to be liable only to the extent of 90 per cent of an actual loss, the remaining 10 per cent being borne by the insured in accordance with the coinsurance clause. No riders are included covering inferior rating. Having no provision for the collection of past-due accounts by the insurance company, and assuming that no rider is included calling for interim adjustment of claims, the insured submits at the expiration of the policy a statement of claims. An adjuster is sent to the insured, where claims are adjusted as shown in the table.

Name	Dun's rating	Gross loss	Gross loss covered and proved	Coinsurance	Salvage	Share of salvage deducted	Net allowed loss
A	D 2	$ 2,500	$ 2,500	$ 250.00	$ 400	$ 400.00	$1,850.00
B	G 3½	1,875	1,250	125.00	500	333.33	791.67
C	K 3½	1,200	.....	.....	375	.....	.....
D	F 4	650	.....	.....	.....	.....	.....
E	C 2	2,850	2,850	285.00	1,275	1,275.00	1,290.00
F	D 1½	1,340	1,340	134.00	460	460.00	746.00
G	D 2½	985	.....	.....	320	.....	.....
H	F 4	3,000	.....	.....	250	.....	.....
J	G 3	1,975	1,500	150.00	200	151.90	1,198.10
K	H 4	435	.....	.....	.....	.....	.....
L	F 3½	1,460	.....	.....	500	.....	.....
M	E 2	3,125	3,125	312.50	930	930.00	1,882.50
		$21,395	$12,565	$1,256.50	$5,210	$3,550.23	$7,758.27
Less normal loss borne by insured							7,000.00
Net amount paid by insurance company							$ 758.27

From the table it is apparent that, although the actual net loss sustained by the insured is $16,185 (gross loss less salvage), he is allowed to prove only $7,758.27. By "salvage" is meant the part of the debt collected or thereafter obtainable, if mutually agreed upon, and value of the goods returned or replevined. Discounts are totally disregarded for our purposes. The difference is accounted for by losses not allowed, by coinsurance provision, and by deductions of salvage. Thus, the gross loss in B was $1,875, the salvage $500, leaving an actual net loss of $1,375. From this gross loss proved and allowed, the 10 per cent coinsurance plus a share of the salvage equal to the ratio of the allowed loss to gross loss

$$\left(\frac{1,250}{1,875} \text{ of } 500\right)$$

are deducted, leaving a net allowed loss of $791.67. Similar calculations have been made in case of customer J, for it is provided in the policy that in case the indebtedness of the debtor to the insured at the time of insolvency is not covered in full by the policy, then all deductions are to be made *pro rata, i.e.*, "in the ratio which the amount covered bears to the whole of such indebtedness."

It will be noted that only $1,250 was allowed on B's account because its lowest capital rating was $5,000, of which 25 per cent was allowed under the policy if rated in second credit grade. Again, on J's account, $1,500, or 30 per cent of its lowest capital rating, was allowed, because the customer was rated in first credit grade. From this allowed loss was deducted a proportionate share of the salvage

$$\left(\frac{1,500}{1,975} \text{ of } 200, \text{ or } \$151.90\right)$$

and the 10 per cent coinsurance, leaving a net allowed loss of $1,198.10. On losses incurred from extensions of credit to C, D, G, H, K, and L nothing was allowed because of inferior ratings.

Arguments for Credit Insurance.—It is argued by advocates of credit insurance that by insuring against extraordinary and abnormal losses a merchant may know in advance just what the loss will be for the ensuing year. It gives him greater control over his costs of doing business. In order to enable him to

compute his anticipated profits with a greater degree of accuracy, all he needs do is to add to all other ascertainable costs the premium paid for his insurance protection, and his normal or initial loss. Obviously, this argument is based on the extravagant assumption that the policy covers all classes of risks sold, irrespective of ratings.

It is also urged that credit insurance tends to make the credit manager more careful. He is forced to keep a closer watch on his customers in order to keep within the provisions of the policy. Since losses are adjusted on the basis of the latest data that was available at time shipments were made, the insured is forced to observe strictly changes in agency capital or credit ratings of his customers. In this manner, credit insurance serves as an inducement for the exercise of caution in granting credit accommodations.

A third argument used in its favor is that, by insuring against excessive loss from bad debts, the insured can afford to take larger chances in passing credits and thus increase his volume of business.

A fourth argument advanced is in case of widespread depression credit insurance makes possible the shifting of extraordinary losses onto the insurance companies, thereby averting the danger of a panic, which might otherwise result. When the peril of such losses is removed, credit becomes more stable. Finally, it is argued that it is just as logical to carry insurance against bad debt losses as it is to insure against loss by fire.

Objections to Credit Insurance.—Some of the weaknesses of credit insurance are plainly revealed in the very presentation of its advantages. In the first place, it is not true that it is possible to predetermine exactly the cost arising from losses occurring because of insolvency of debtors during the term of the policy. The insured does not exercise greater control over his costs, for several reasons. To begin with, credit managers deserving of their positions would not under any circumstances follow blindly the ratings of mercantile agencies and disregard information from all other sources. No sane creditor would refuse accommodations to a merchant who has no rating, but whom other sources of information show to be worthy of a line of credit. To be sure, all losses occurring from sales to "off-rated" accounts may be covered by the policy by special riders, but the expense involved is almost prohibitive. To the extent

to which certain classes of risks are not covered to that extent at least is it difficult to predetermine accurately the aggregate loss which will be suffered during the policy period. Again, even though the wild assumption is made that the insured will stupidly follow the ratings in his credit extensions, what assurance is there that the losses will not exceed the face of the policy?

It is doubtful whether credit insurance induces care and caution on the part of the insured in the handling of his accounts. The fact that the credit manager is dividing his responsibility by shifting all possible excessive loss onto the insurer is apt to make him more lenient. If inclined to take larger chances in passing credits or to shirk his responsibility for investigating his risks thoroughly because of the protection afforded by the policy, his actions will ultimately prove against the best interests of his house. It is bad policy to rely mainly on an insurance policy to make good credits granted under its provisions in the event they develop into a loss. Furthermore, it militates against the best methods in credit granting if reference to the policy must be made each time an order from an off-rated customer is passed upon. It is not even necessary that the credit manager himself watch the accounts in order to keep them within the provisions of the policy. Any clerk or bookkeeper can effectively discharge such mechanical and routine duties. Some credit managers may even disregard the policies altogether, feeling that they can afford to take undue risks and, instead of serving as a curb on his caution, it stimulates undue liberality and leniency, for as long as he can thereby increase the volume of business, his house will stamp its approval on his actions, even though losses are incurred which are covered by insurance. Accordingly, there is less incentive to make a good showing by a reduction of bad debts. Even the most ardent advocates of credit insurance are compelled to admit that the tendency is for the insured to exercise greater liberality in their credit extensions in order to make a pecuniary gain off the policies.

The argument that, in case of widespread depression, a panic is averted by shifting the extraordinary losses onto an insurance company is equally unsound. Credit losses, as fully demonstrated hereinbefore, cannot be shifted in their entirety. To the extent to which such losses cannot be shifted, to that extent is this argument unsound. Moreover, instead of preventing a pre-

cipitation of failure of debtors who are unable to meet their obligations during such period of inactivity, credit managers may, by placing great confidence in the security of accounts covered by insurance, become careless in collecting their accounts, and thus invite losses. If it is provided that these past-due accounts shall be collected by the insurance company, it is not unlikely that, instead of averting the panic, it will only be hastened and accentuated because of the greater pressure that will be brought to bear upon the debtors by the insurance company which is interested primarily in an immediate settlement, irrespective of the consequences to the debtor or the insured. Furthermore, when the losses are so severe because of a general depression that individual creditors find themselves unable to carry them, it is doubtful whether credit companies could stand the strain. Besides, the insured would find their policies not large enough to cover all of these losses.

It is hardly logical to compare credit insurance with fire insurance. A fire may destroy every dollar in property that a merchant possesses, and within a short space of time. Such a risk is too heavy to be carried alone. On the other hand, it is hardly conceivable for a merchant to lose all his accounts receivable in any one year as bad debts. If any comparison at all is attempted between credit and fire hazards, the insurance against credit losses should be based on the principle underlying insurance against fire where the risks are sufficiently scattered. Thus a concern with several hundred buildings located in different parts of the country might and successfully does carry its own fire insurance. When accounts are large in number and well distributed, no credit insurance need be carried save a reserve on the merchant's own books. Even though in some one year a concern's losses may exceed a certain normal percentage as determined by its experience over a period of years in the past, the average of the next several years will probably be no higher. And if this average is higher, it cannot be insured against, but must be borne by the insured as a normal or initial loss, for in determining the terms covering renewals, the experience of the previous year is taken into consideration so that in the event the loss incurred during the term of the preceding policy is higher than the average loss of the past five or six years, the initial or normal loss is increased accordingly. Consequently, when averaged over a period of years, the insured will find that

the premium will only be so much additional, to be charged to the loss account, over what would normally be charged off when not carrying any credit insurance.

Another criticism against credit insurance as practiced today is aimed at the method of computing the initial or normal loss. It will be observed that in determining the normal loss the insurance company computes all losses, including those which are not allowable under the policy because of inferior ratings and other stipulations of the agreement, notwithstanding the fact that the losses on these accounts constitute an important or even major part of the aggregate losses. If off-rated accounts are not allowable under the policy, they should not be considered in arriving at the initial loss to be borne by the insured. Thus, the normal loss of $7,000 undoubtedly includes losses of the character of C, D, G, H, K, and L, whose ratings are too poor for the purposes of the policy. Since these losses amount to $6,285 (gross loss less salvage), it is necessary that the insured sustain a total of $13,285 ($7,000 plus $6,285), disregarding other stipulations for the normal losses, before the insurance company would have any liability. This treatment has been condemned as unfair to the insured.

From the foregoing it is apparent that credit insurance, as at present conducted, protects the insured to a limited degree against certain unanticipated losses. It has already been fully demonstrated that over a period of years credit insurance necessarily adds to the cost of doing business an amount equal to the premiums paid out over and above the amounts received as indemnification for losses under the policies. Insurance companies, in order to remain in business, must receive premiums greatly in excess of the losses paid. From this excess all expenses incurred in soliciting and conducting business are covered, as well as a profit secured. Should the losses in any one year exceed the premiums received, the difference will be more than made up during subsequent years, because the normal losses of the insured are automatically raised and the premium paid also becomes correspondingly larger, partly because of the increase in the face value of the renewal. It is, therefore, argued that because it is cheaper in the long run for a merchant to carry his own credit insurance, also because his risks are scattered over a large number of accounts, he should merely set up a reserve for bad debts sufficient in amount when accumulated from year to year to

cover all possible unexpected losses. In the case of some concerns selling relatively few accounts, however, and where the risk is, therefore, inadequately distributed, it may be advisable to have their risks underwritten. But such firms are likely to find the cost of protection prohibitive. Moreover, many credit managers feel that accounts insurable at reasonably low rates represent a sufficiently high degree of credit responsibility to obviate the necessity for protection, and that where the insurable rates are high, the accounts represent inferior credit risks to whom credit could not be extended without protection. The cost of protection on these cases, however, is so high as to absorb nearly all profit, leaving little, if any, benefit to the insured from insuring against losses from such risks.

Foreign Credit Insurance.—During the first two years following the World War, many losses were sustained by exporters because of bad debts. These losses were undoubtedly due to the disturbance of economic equilibrium caused by the war, and the carelessness with which credit was extended during the period of general prosperity. Apparently, without a careful analysis of these factors, many exporters felt that exporting must cease on a credit basis, or else some form of protection should be devised whereby excessive losses could be eliminated or minimized. Instead of seeking the remedy within each concern, through more careful investigations of credit risks on the part of credit managers, a group of manufacturers attempted early in 1919 to organize an association for the purpose of providing some form of credit insurance on a mutual basis. An investigation disclosed the impracticability of attempting to insure against all contingencies because of the prohibitive cost of such protection. Since losses from actual insolvency of foreign buyers, death, disappearance, etc., were relatively low, it was decided that insurance be offered against such contingencies at a reasonable rate.

From contributions made by interested parties, a department was organized for the collection of data on which to base rates for insurance. Considerable information was secured from the credit files of numerous American and foreign banks, culminating in the issue of a rating book covering numerous buyers in Latin America. Actual insurance against insolvency of foreign buyers was finally begun in the early part of 1921.[4]

[4] POOLE, GORDON C., "Export Credits and Collections," p. 68.

The membership grew, as a result, from 100 at the beginning of the year to about 500 at the end of the year. In the early part of 1922 an organization was formed in New York City which offered to sell foreign insurance against all contingencies. It is doubtful, however, whether it will succeed in selling complete credit insurance to any one exporter covering a given transaction. In the absence of adequate data upon which to base premium rates, these rates would of necessity have to be sufficiently high to afford protection against wrong guessing on the part of the insurer. Even though sufficient statistical data were available as a basis, the cost of complete insurance would undoubtedly prove prohibitive. Furthermore, losses would materially increase on account of the carelessness in collecting accounts which such protection would stimulate.

Unlike domestic credit insurance policies, foreign policies, as at present employed, expire 30 days from the date when the account covered matures, although such policy is renewable at a certain specified monthly premium at the option of the insured. Thus, if a shipment is made to a merchant in Montevideo on terms of "60 days sight draft against documents," the account becomes due approximately three months from date of invoice, assuming 30 days to have been consumed by the goods in transit. If this shipment is covered by insolvency insurance, the merchant in Montevideo must become insolvent within four months from date of shipment; otherwise the exporter cannot collect insurance on the bill. Even though the merchant became insolvent within the specified period of time, the exporter may not be informed on time, unless he instructs the banker with whom the draft was placed for collection to notify him by cable in case of non-payment of draft at maturity. This constitutes an expensive procedure, particularly when reasons for non-payment must be cited in detail. The other alternative is to renew the policy before the status of the draft has been definitely determined, thus involving additional and frequently unnecessary expenditure. In any event, the protection is costly, particularly when disputes arise regarding the date of arrival of the goods, amount of draft, and the like, requiring an extended period of time for final settlement. But since the outcome is somewhat problematical, it would be necessary to incur additional expenses if protection is sought, by constantly re-

newing the policy at monthly intervals until the bill is finally settled.

In its main outlines foreign credit insurance differs but slightly from domestic credit insurance. Exactly the same principles apply to both. What is true of one, as far as usefulness of the protection is concerned, is equally true of the other. Because of the preponderance of objections, one is forced to the conclusion that the strong, able, and watchful credit manager who has complete knowledge of all factors affecting the risk is apt to consider credit insurance a burden carried for the benefit of the weaker creditor. The well-informed, well-trained credit manager usually adopts such measures and follows such principles which tend to minimize losses. On the other hand, if losses are covered by insurance, it is not the credit manager, if disposed to shirk his responsibilities, who renders decisions, for credits are then based on the terms of the policy; and in granting credit he does so because the account is covered by his policy; or in refusing credit against his own better judgment, he takes that action because the account for some reason does not come within the requirements of the insuring agreement.

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APPENDIX

CUSTOMARY TERMS OF SALE

The following customary credit terms are submitted in order to acquaint the student with some of the practices in different lines of trade. The bulk of this information has been gathered together by W. H. Steiner, of the Statistical Department of the Federal Reserve Board, and charted by John Whyte, Director of Education and Research of the National Association of Credit Men, in the "Credit Man's Diary" of 1923. Certain portions of this list were adopted from a compilation made by R. F. Prudden in his "Bank Credit Investigator," and the remainder supplied by the author.

Anthracite Coal: S.D.-B.L. to 30 or 60 days net. In certain cases terms are one-half per cent 10 days, net 30 days.
Automobiles: To dealers, S.D.-B.L. attached.
Automobile Accessories: Manufacturers' terms, 2/10, net 30 days.
Bacon: One-half per cent 10 days; also one-half per cent 10 days, net 30,
Bale Goods: 2/10, net 60.
Bars (Sheet): One-half per cent 10 days, net 30.
Beans: One and one-half per cent in 10 days, net 30 days.
Bearings: 5/10, net 30.
Bedding and Pillow Material: 2/30, net 60.
Blankets (Retail): 2/10, 60 days extra.
Blanks (For cut glass): 1/30, net 60.
Bolts, Rivets, Nuts: Less than ½ inch, 1/10, net 30.
Bottles: 1/10, net 30.
Boxes: 1/10, net 30.
Brass, Copper, Rods, Wire Sheeting and Tubing: 1/10, net 30.
Brick (Common): Five per cent E.O.M.; varies as low as 2 per cent, depending on locality, etc.
Brick (Face): 1/10 days; also 2/10 days.
Builders' Supplies: Two per cent, tenth proximo.
Candy (Bulk): 2/10, net 60 days.
Canned Goods, General (Maine and Colorado): 1½/10, net 60.
Carpets (Regular Stock): 4/10, 60 extra.
Carpets (Made to Order): 4/10, net 60 days.
Cement: 3/10 days.
Chemicals and Drugs: 1/10, net 60; also 2/10th proximo; medical and technical, 1/10, net 30; chemicals, Pacific Coast, 1/30, net 60; drugs,

general, 2/10 days; drugs, general, large wholesale houses, 2/10, net 60 days.

Chili Con Carne: One and one-half per cent 10 days, net 30.

China: 1/10 days.

Cigarettes: 2/10, net 60.

Cigars (Imported): 1/10, net 30; domestic, 1/10, net 60; in some instances terms run net to 4 months.

Clams (Minced, Pacific Coast): 1½/10, net 30.

Clothing Material (Men's): 2/60, net 120 days.

Clothing (Men's): 4/60 days; 6/10 days; 7/10 days; 8/10 days; 9/10. Probably the commonest terms are 7/10, 60 extra to 4 months net; also 7/10 season's dating, 30 days net.

Coal and Coke: S.D.-B.L. to 30 or 60 days net.

Coat Leather: 2/10, net 30.

Coats and Suits: 2/10, net 30; also 5/10 days.

Coffee: Green, to small jobbers, one-half per cent 10 days, net 30; roasted, 2/10, 30 days extra; roasted, in West, 2/10, net 60; green, 2/10, net 90 days; jobber to retailer, roasted, 1 to 2/10, net 30 days.

Collars (Men's): 5/30 days; also 6/10 days.

Confectionery: Manufacturers' terms 2/10, net 30 to 60 days.

Containers, Shipping (Shooks): 1/10, net 30; 2/10, net 60.

Corduroys (Men's and Women's): General terms, 10/10 days; also 8/60 days.

Corsets: Local trading, 2/10, net 30; Pacific Coast, 2/10, net 60; terms 5/10 used to moderate extent; retail terms, 5/10, 60 extra, also 7/10 days.

Cotton (Raw): S.D.-B.L. attached.

Cotton Goods: 2/10, 60 days extra. Also season's dating, which is October 1 and April 1. Delivery is usually made from May for October dating and from November for April dating.

Cultivators (Wheel): 1/30, net 60.

Cut Glass: 1/30, net 60; also 2/10, net 30 days.

Decorations (Interior): 6/10, net 60 days.

Drugs and Chemicals (See "Chemicals and Drugs").

Druggists' Sundries: 2/10, net 30.

Dry Goods: 2/10, net 60 days; also 2/10-60 with an extra 1 per cent for payment within 10 days.

Electrical Products: 2/10 to 5/10, with net terms varying from 30 to 60 days.

Envelopes: Wholesale, 3/10 days.

Fabrics (Worsted): 7/10, 60 extra.

Feathers: To manufacturers, 10 per cent E.O.M.

Fish (Canned): One and one-half, 10 days, net 30 days.

Flour: One and one-half per cent 10 days, net 60 are used extensively; 1/10, net 30 used in rare cases. Terms vary according to grade, size of shipment, keenness of competition, and the like. S.D.-B.L. often employed on carload shipments.

Fruits and Vegetables (Canned): By packer, 1½ to 2/10, with net period varying from 30 to 60 days; wholesaler to retailer, 1/10, net 30 to 2/10, net 60.

Furniture: General terms on less than carload lots are 2/30, net 60 days; on carload lots, 5/30, net 60 days. Occasionally, 4/10, 60 extra. Terms are not strictly adhered to due to competitive conditions.

Furs: 2/10 days on cheap grade; 7/10 days on best grades.

Gasoline: 1/10 days.

Glass: Window plate, 1/10, net 30 days; flint and lime, 1/15, net 30.

Glove Leather: 1/10 days; also 2/10, net 30; also 2/10, net 60; also 3/10 days.

Gloves: 5/30; also 6/10 days; 6/30; and 7/10 days.

Gray Goods (Unfinished): 3/10, net 60 days.

Groceries: General items, wholesale, 1/10, net 30; canned goods, 1/10, net 60 days. Wholesaler to retailer, there are three classes of goods from standpoint of credit terms:

1. "Shelf Goods" are sold on 1/10, net 30 to 1½/10, net 60.
2. Sugar, butter, etc., are sold on 30 days net with no discount.
3. Teas are sold 3/10, net 3 to 4 months.

Hams: ½/10 days; also ½/10, net 30 days.

Hardware: 2/10, net 60 days. On "builders' hardware" proximo terms are frequently employed. "Shelf hardware" is often sold on 2/15, net 30 days and R.O.G. terms; also 2/10, E.O.M.

Harness Leather: 2/30, net 60 days.

Hats (Panama): 2/10, net 30; also 5/10 days.

Harvesting Machinery: 5/60 days; 5/30 terms used as a seasonal variation.

Hay Cutters: 5/60 days; 5/30 terms used as a seasonal variation.

Hides and Skins: S.D.-B.L.

Hosiery (General): 1/10 days; to retailers, terms very extensively used are 2/10, net 30 days; heavy woolen, 2/10, 30 extra, and 2/10, 60 extra; also 2/10, net 90; other general terms are 5/10 days to retailers, and 6/10 days.

Implements (Agricultural): 2/10, net 60 with season's dating.

Ingots: One-half per cent 10 days, net 30 days.

Iron (Pig): Net 30 days.

Iron (Rolled): One-half per cent 10, net 30 days.

Japanese Goods: 2/10, net 60 days.

Jewelry: 5/30, net 4 months. Plain gold rings sold on 30 days net. Loose diamonds sold on 6 to 9 months, settlement being commonly made by note or acceptance. Silverware, both of the "flatware" and "hollowware" types, is sold on 2/30, net 4 months.

Kerosene: 1/10 days in Middle Atlantic States.

Ketchup, etc.: 1/10, net 30, and 2/10, net 30 days.

Laces: 7/10, 60 extra; small industries, domestic, 8/10 days.

Lard: 2/10, net 60 days.

Lead (Chemical Sheet): 1/10, net 30; to manufacturers, 2/15, net 60.

Lead Pipe (Chemical): 1/10, net 30.

Leather: 1/10 on glove leather; on fancy goods, russet, collar and coat, 2/10, net 30, and 2/10, net 60; also 3/10 days; shoes, soles, 3/30; also 4/10; uppers for shoes, 4/30, and 5/10 days.

Lever and Disc Harrow: 1/30, net 60.

Linseed: To manufacturers, 1/10, net 30 days.

Lumber: 1/10, and 2/30 days; wholesale, 2/10, and 2/30, net 90. Also S.D.-B.L. to 30 or 60 days net on timber lien notes, freight net cash upon receipt of each car.

Machine Tools: 2/10, net 60 days.

Meats: Smoked and cured, 2/10, net 60; also net 30 days with no discount; canned meats, S.D.-B.L. attached on carload shipments; otherwise ½ to 1/10, net 30 days; fresh meats sold on "cash terms," meaning that goods must be paid for within 7 days after delivery.

Medicine: 1/10, net 60 days.

Merchandise (General): 2/10, 60 extra, terms used extensively.

Milk (Condensed and Evaporated): To wholesalers, 2/10, net 30.

Mill Supplies: 2/10, net 30 days.

Millinery: General, 4/60; 5/30; 7/10, 60 extra; and 9/10; millinery and braid, 6/10 days.

Musical Instruments: 2/10, net 30.

Neckwear: 5/10, 60 extra.

Nightwear: 2/10, 30 extra; 2/10, 60 extra; and 3/10 days.

Office Appliances: 2/10, net 30; and 2/10, net 60.

Oils: 1/10, net 30; branded, carload or less, 1/10, net 60; linseed oil, 2/10, 30 extra.

Overalls: 1/10; 2/10 days.

Paints: 1/10, net 30; paints and varnishes, dry packets, 2/10, net 30; mixed paints, 2/10, net 60.

Paper: 2/10, 30 extra on book paper, printing paper of fine grade, towel and toilet, and waxed paper; 2/30, net 60 days on wrapping paper, wholesale; and 3/30 days on book, cover, mill, and wrapping paper. Cash discounts largely used and net terms are unusual.

Peanut Butter: 1/10, net 30.

Phonographs: 2/10, net 30.

Piece Goods: 7/10, net 4 months; woolen, 10/10, net 30.

Pipes, Tubings, and Fittings: 2/10, net 30 or 60 days.

Pottery: 1/10; 2/10, net 30.

Preserves: 2/10, net 30.

Rails: ½/10, net 30.

Rivets: One-half inch and larger, ½/10, net 30 days.

Rods (Wire): ½/10, net 30.

Sardines (Maine): One and one-half per cent 10 days, net 60 days.

Sauces: 1/10, net 30; 1½/10, net 30; 2/10, net 30.

Saws: 2/10, net 30 days.

Seeding Machines: 5/30 days.

Shipping Containers (Shooks): 1/10, net 30; 2/10, net 60.

Shirts (Working): 1/10; 2/10; 2/10, 60 extra; others, 2/10, net 60.

Shoes: 1/10 days in New England; to retailers, 2/10, net 30; 2/10, net 60; 3/10; to department stores, all styles, 5/10 days.

Silk: Thrown, 2/10, net 90 days; 6/10, 60 days' dating, with season datings January 1 and July 1. Raw silk, European, 60 days. Japanese raw silk, 4 months net, settled mostly by trade acceptances. Spun silk, 6/10, net 30; broad, ribbon, 6/10, net 60.

Silverware (Sterling): 2/10, net 30.
Skirts: 2/30; 3/10; and 8/10.
Soups (Canned): 1/10, net 60; 1½/10, net 30.
Spices: 1/10, net 30; 2/10, net 60; whole, 1½/10, net 30.
Spools: 1/10 days.
Stationery: 2/10, net 60.
Steel: ½/10, net 30 days.
Sugar (Refined): To wholesalers and manufacturers, 2/7 R.O.G.
Suspenders: To jobbers, 2/10, 60 extra.
Teas: Importer to wholesaler, 3/10, net 4 months; wholesaler to retailer, 2/10, net 120 and 5/10, net 60 to 120 days.
Textiles: Cotton cloth, 2/10, 60 extra. Cotton in the gray, 10 days net. Woolens (piece goods), 7 to 10 per cent discount with net period varying from 30 days to 4 months. Dress goods, including worsteds, 7/10, 60 days' dating; also season datings; sometimes 30 days net E.O.M. Silk goods, 6/10, 60 days' dating; sometimes 7/10 E. O. M. Linens, "regular terms," 6/10, 60 days' dating; "net terms," 2/10, 60 extra; "net net," spot cash, with no discount and no dating; also 3/10 E.O.M. and 3/10 R.O.G. Velvets, including plushes, 6/10, 60 days' dating, with season dating as of April and October 15; to manufacturers in the millinery trade datings are as of January and July 1.
Tiles: General, 3/30, net 60 days; hollow, building, 5/15 days.
Tin Plate: 2/10, net 30 days.
Tire Rims: To retailer, 5/10, net 30 days; 5/10th proximo.
Tires (Rubber): 5/10th proximo, used extensively when discount is given.
Tobacco: Smoking, twist, plug, 2/10, net 60.
Towel Material: 3/10, net 60.
Trousers: 5/60; 6/30; and 7/10.
Tubes: Seamless, 2/10, net 30; welded, 2/10, net 60.
Underwear: Knit, wholesale and retail, 1/10, net 30; heavy weight, wholesale and retail, 1/10, net 60; light weight, wholesale and retail, 1/10, 60 days extra; cloth, wholesale and retail, 2/10, 60 extra; general, 2/10, net 90; light weight, wholesaler, 2/30; cotton, women's, 7/10, 60 days extra; muslin and cotton, women's, 8/10.
Upholstered Furniture: 2/30, net 60 in most cases; 5/30, net 60.
Upholstery (Auto): 2/10, net 60; 6/10, net 60.
Varnishes: 1/10, net 30.
Varnishes and Mixed Paints: 2/10, net 60.
Velveteens: 6/10, net 60.
Wagons: 5/30; also 5/60.
Waists: Women's, cheap grade, 2/10.
Watches: Trade-marked, 6/10 to 30 days, net 4 months.
White Goods: 2/10, net 60; also 2/10, 60 extra.
Wire Goods: 2/10, net 60.
Woolens and Worsteds: 7/10, net 4 months; also see "Textiles."
Yarn: 1/10; 2/10; 2/10, net 60; yarn and thread, rare instances, 1½/10, net 60 days.
Zinc: High-grade, usual terms are ½/10 days; for purchasers of high standing, ½/10, net 30 days.

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